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MEDIA OWNERSHIP: DIVERSITY AND CONCENTRATION

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BEFORE THE

SUBCOMMITTEE ON COMMUNICATIONS

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

MEDIA OWNERSHIP: DIVERSITY AND CONCENTRATION

JUNE 14, 21, AND 22, 1989

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MEDIA OWNERSHIP: DIVERSITY AND CONCENTRATION

WEDNESDAY, JUNE 14, 1989

U.S. Senate,
Committee on Commerce, Science, and Transportation,
Subcommittee on Communications,
Washington, DC.

The subcommittee met at 9:05 a.m., in room SR-253, Russell Senate Office Building, Hon. Daniel K. Inouye (chairman of the subcommittee) presiding.

Staff members assigned to these hearings: Tom Cohen; John Windhausen; Toni Cook, staff counsels; and Gina Keeney, minority staff counsel.

OPENING STATEMENT BY SENATOR INOUYE

Senator Inouye. The Communications Subcommittee begins work this morning on a subject of intense interest to the members of this subcommittee and much of the public, and that is the ownership of America's media. The depth of our interest stems from the fundamental precept that for democracy to work, citizens must have access to sufficient information about activities and events, both in the public and private sectors that affect their welfare. If information is either withheld or otherwise not forthcoming, our entire system is in jeopardy.

As a surrogate for ensuring the free flow of information, we have long examined the ownership of the media. While a media owner may in theory publish views different from his own, he is far more likely to limit in one way or the other views that he does not support, and that is to be expected. That is also very troublesome. It is for this reason as well as because of concerns about economic concentration that for half a century the federal government has pursued policies that limit the ownership of media outlets.

It is now time with all of the changes in the media market, many of which were brought about by changes in government policy, to determine where we stand and what needs to be done. Has the media market become too concentrated? Are new rules required? Should old rules be changed?

Over the next eight days the subcommittee will hold three hearings exploring media ownership issues. During this time we should be able to examine the major issues in depth and, if necessary, further hearings will be held and, in fact, I plan to hold a hearing this fall devoted solely to the issue of minority ownership.

The structure for the hearing will be as follows: This morning's hearing will focus on the overall media market where it has been, where it is today, and where it is going. The witnesses this morning from the industry and academia will provide a context for the specific ownership issues and disputes we will explore in the next few days of hearings.

The second hearing will focus on media ownership issues in the cable television industry. This subcommittee has dealt at various times with concerns about vertical and horizontal integration in the industry. This hearing will provide an opportunity for us to aggregate all of these concerns and examine basic issues about market power in this industry.

The final hearing is devoted to the broadcast industry. Over the years this industry has faced great scrutiny from the government and many rules restricting ownership are now in effect.

This hearing will explore the current marketplace to determine whether any rules should be changed or repealed or whether new rules should be added.

I am delighted that the Chairman of the Antitrust Subcommittee of the Judiciary Committee, the Senator from Ohio, Senator Metzenbaum will lead off our hearings. His dedication to competition and diversity are well known, and his talents are greatly respected by all of us and I know that he has already explored in his Subcommittee some of the issues we will be dealing with. And I believe his views will prove invaluable.

We will then hear from two of the most respected leaders in the media industry. They are there to present the history and future of the industry from their perspective. Mr. John Malone, Chairman of TCI, has constructed the largest and possibly finest cable T.V. operation in the United States. He is recognized as someone with a clear and coherent vision of where the media area headed from the broadcast industry, with Mr. Fred Paxton of WPSD-TV in Kentucky. Mr. Paxton has extensive experience in the industry as a local broadcaster, as the heading of the NBC Affiliates Board, and President of the Association of Maximum Service Telecasters. And I feel most fortunate that both of these industry leaders could be here this morning to provide us with insights into the direction of the media.

On the second panel will be three prominent professors who have spent a great deal of their time studying the media, Professor Ben Bagdikian of the University of California at Berkeley, Professor Michael Salinger of Columbia University, and Professor Barry Litman of Michigan State.

Each of these professors have published extensively, and their work is both thoughtful and provocative.

Before I welcome these witnesses and hear from them, I would like to call upon Senator Packwood.

OPENING STATEMENT BY SENATOR PACKWOOD

Senator Packwood. Mr. Chairman, thank you. Needless to say, I appreciate your calling these hearings. This is a subject I have watched with interest ever since I have been on the Commerce

Committee. I think I share many of the views of the Senator from Ohio about diversity and competition.

The one thing I have discovered, however, is that in the bulk of the towns, at least in my state—I do not know about Ohio and others—citizens do not suffer from a lack of access to information. And I distinguish that from information. Do they receive it? Do they get it? Do they absorb it? On many occasions, no. Do they have the access to it? Yes.

In any town of any normal size in Oregon they have access to more than three television channels, many, many more than that with cable. At least one principal newspaper in even the smallest of towns—you would have to get below 10,000 before you would not have a daily paper—and radio stations galore with diversity of programming beyond imagination, some of which have next to no news, some of which have all news, all of which seem to have some news in the area of every hour or half hour.

Citizens do not lack for access to information, including diverse information. Whether any of this media is dominant and needs to be regulated, I find an interesting question because, in my experience, a dominant force in most towns, it is usually the single newspaper, and it is an unusual town that has more than one newspapers and certainly more than one dominant newspaper.

I doubt if there is any television station in the Washington metropolitan area, let alone a radio station that could or would do the in-depth job that the Washington Post is now doing on the savings and loan industry. I think the recent Post article on savings and loans probably will have more effect on what Congress does than anything that local television could do. And if local television tried to do it, my hunch is many of the viewers would turn to another channel, just as many of the readers of the paper do not read the S&L story, but those who do read it are heavily influenced by it.

That is not an argument to regulate the Washington Post or deregulate television. But I am simply saying as a matter of fact, I think we sometimes overemphasize the influence that broadcast media has, and we underemphasize the influence that print media has, knowing full well we cannot regulate it anyway, nor do I think we should.

This committee well knows my views generally about the regulation of the broadcast media. With very few exceptions, I do not like it. And with every growing year, I become more convinced that the diversity that exists seems to outrun the concentration that continues. That does not preclude my views about antitrust or concentration, but it seems no matter how much the concentration continues, more and more diverse sources seem to come along.

So, I look forward to these hearings with a very open mind, Mr. Chairman. I am not adverse to some changes in ownership, if necessary, or some changes in law, but I certainly come at it with a very, very questionable view regardless of the answer to that question whether or not we need any content regulation as to any of the media sources, whether they are broadcast or print, that exist in this country.

Thank you very much, and at about 9:27 or 28 I have got to leave and go to another hearing.

Senator INOUYE. Thank you.

Senator McCain.

OPENING STATEMENT BY SENATOR McCAIN

Senator **McCain**. Thank you, Mr. Chairman. I generally share the views of my friend from Oregon and would associate myself with his remarks.

I think it is worth mentioning that according to the polls that I have seen, 70 percent of the American people state that they get their news from television rather than print sources, although I do not underestimate the critical role that print media plays.

I think it is still true that a substantial majority of Americans form their opinions to a large degree by what they see on television rather than what they read.

Mr. Chairman, I agree that these are important hearings. As we approach these hearings, I think it might be valuable for us to recollect for a moment the enormous changes that we have seen in the last ten years—growth in the number of broadcast stations, shift in audience share, changes in programming, growth of new distribution technologies. And as we talk about the changes, a lot of our conversation will be about cable.

I think it is also well to note the enormous growth in the so-called dish industry, the satellite receivers throughout America. It is interesting to note that over half the nation's households now are hooked up to cable. That is an indication of not only what has happened, but what we can expect.

The Department of Commerce has said there are more homes now with television sets than have telephones or indoor plumbing.

I think that there are significant and exciting changes that are still to come with HDTV, and the efficiencies gained from fiber-optic cable, more and more sophisticated services being delivered to the home over fancier equipment.

The structure of the industry is changing and adjusting. We are seeing mergers, vertical integration, and cross ownership.

That is what we have to look at today. I will look forward to the views of our distinguished friend from Ohio.

I think that what needs changing, what will adjust itself, and what should Congress do, if anything, is hopefully going to be the result of these hearings.

I think our goal is to have a vital industry that encourages the movement of information and ideas, which is obviously a critical thread in this country's fabric.

I also think at some point during these hearings we will be focusing on the cable industry and whether it is indeed providing to the viewers and the rate payers—and they are rate payers—the kinds of services that they promised and promoted when they received the franchises that they have obtained all over the country at substantial financial gain to themselves.

I thank you, Mr. Chairman, for holding this hearing, and I look forward to not only this one but the two following. Thank you.

Senator **Inouye**. Senator Gorton.

OPENING STATEMENT BY SENATOR GORTON

Senator **Gorton**. Thank you, Mr. Chairman. I believe that Senator Packwood was totally accurate when he pointed out that the average person in the United States whether living in a major urban area or in the smallest of towns undoubtedly has more sources of both information and entertainment available today than ever before in our history and that that kind of availability continues to grow apace.

I think that the Senator from Oregon is also entirely correct when he both deprecates and fears any attempt on the part of the Congress to regulate information, to regulate communication.

I do not believe that the principal thrust of these hearings, however, is some attempt to tell those in the newspaper business or the television business or the cable industry what they should communicate to the American people.

I think that, Mr. Chairman, you are concentrating more heavily on the distribution of information and whether or not increased concentration and mergers cut down on the ability of the American people to seek alternatives sources for the same kind of information and the dramatic increase in growth and strength of the cable industry, for example, does raise questions.

That is partly of concentration but most particularly of whether or not the consumer has any reasonably available alternative method by which to gain the same kinds of information. I think in that field serious questions are raised by the dramatic changes which are taking place in the marketplace, and it is on those questions which these hearings are as they should be focused.

Senator **Inouye**. Thank you.

Senator Burns.

OPENING STATEMENT BY SENATOR BURNS

Senator **Burns**. Thank you, Mr. Chairman. I just want to thank you for holding these hearings.

Before we get into it, I appreciate those who will be appearing before this committee, taking time out of their busy schedule and trying to enlighten us on their particular problems or their particular industry. I look forward to their testimony, and thank you for very much.

Senator **Inouye**. Thank you.

Now, may I call upon what some consider as the conscience of the United States Senate, the Honorable Howard Metzenbaum.

STATEMENT OF HON. HOWARD METZENBAUM, U.S. SENATOR FROM OHIO

Senator **Metzenbaum**. Thank you, Mr. Chairman. Thank you for your kind comments.

I would like to commend you once again for your leadership, starting the meeting at 9:00 in the morning, having a series of hearings on this very controversial subject, getting an excellent turnout of membership to show up this morning and moving forward with dispatch on a subject that is of major interest literally to 230 million Americans.

We are talking not about access to news. I think I totally agree with my friend Bob Packwood that certainly there is very adequate access to news. You can get the news. The question goes beyond the news. The question goes to the kind of programming that you get, what you can see in your home, whether you can see baseball games, whether you can see certain entertainment programs, whether you can see certain movies, whatever the case may be.

What we are talking about here is a situation that is of concern to our Antitrust subcommittee. We have held hearings on it, but I immediately made it very clear at that point that the jurisdiction with respect to legislation in this area, other than the specific antitrust aspects belongs entirely in this committee's jurisdiction, and I respect that and I am very proud to have an opportunity to be here.

The question that we are talking about has to do with the fact that first we had a tremendously powerful T.V. industry in this country. Then, a fledgling operation that none of us understood too well called cable began to develop. And it started moving around a bit and it was going to put lines in people's homes, and it suddenly became from the very little cable operation, a very major factor.

And, as a matter of fact, with few exceptions, you have a monopoly situation in the area of cable. Although Congress said that the cities had the right to regulate rates, Congress also said that cities could not regulate rates if there was competition in the area.

I think we were contemplating two or three or four cable operations, but the FCC came up with what I consider to be an absurd decision in which they said there was competition if you had three T.V. stations in the area.

Well, there is hardly a place in the country that does not have three T.V. stations in the country and as a consequence, cable became totally deregulated with respect to rates, and in the last year or so their prices have increased at a greater rate than any other single product in our economy, higher than any other single product.

In recent years, the cable industry has moved into the area of programming. The cable industry has moved very effectively into various areas of program production and with that program production they started to squeeze out competitors. They would not sell it to everybody. It was not just a question of everybody coming in and being wiling to buy it, but they were saying who could buy it, who could not—using their strength in that respect.

They also have been able to use their strength with respect to the broadcast industry itself, and to take a station that maybe is on Channel 4 or Channel 7 or Channel 9 and put it up on 22 or 36 or whatever the case may be to the detriment of that station and at a tremendous loss as the viewer tries to find it on 22 or 36 as the case may be.

Now, we have a situation where cable is pretty much noncompetitive, and we have a situation where cable and production have become so intertwined that it has become pretty much noncompetitive, and the wireless cable which is sort of an offshoot, a little fledgling operation attempting to compete with cable is having difficulty in doing so because it cannot buy the product from the producers of various programs that are so much in demand by the viewers.

Now, the Time-Warner merger became a very challenging one because you had both of them in cable, both of them in production, and the antitrust department took a look at it, followed its usual procedure in recent years. It said no problem.

Now, we find Paramount has come into the picture, and you find that as you look at these whole groupings you see that Time has cable systems. It is the second biggest. It has HBO and Pay Movies and Cinemax. It has a 14 percent interest in Turner Broadcasting which includes CNN, WTBS, and TNT if my recollection serves me right. I think it has an option with respect to purchase of CNN, and it has magazines, and Time-Life Books.

You have Warner with Warner Cable, which is the fifth biggest, Warner Brothers Studios, Lorimar Television, Warner Brothers Records, Warner Books, and Time-Warner intends to create new cable program networks as well.

And now you find Paramount moving in and upsetting the Time-Warner merger applecart and Paramount comes in with movies, fantastic T.V. production studios, cable channels—USA, and MSG—Simon & Schuster Books, Prentice Hall Books, and so more and more you see this joining together, this strengthening of those who are in the area.

Now, frankly, Wall Street loves it. The press is enthralled. The bottom line for consumers and the creative community is that they are going to get less product or, if they get the product, they are going to be paying more for it. It raises the threat of higher prices and less diversity.

And the integration of the production studios with the cable operations suggests more new programs will bypass free T.V. and go directly to cable channels, and I frankly believe that what is happening in the cable industry and in the production aspect as well poses a real threat for the viability of the network T.V. stations and the non-network T.V. stations maybe even more than that.

Until now the goal of our public policy was to separate control of the creation and production of programming from the control of the distribution. But these two pending mergers totally distort that fact and provide cause for concern. When you have the integration of content and conduit, you find that the claim is you are creating a synergistic effect. The claim is that this is going to help them compete internationally. Well, it may help them compete internationally, but domestic users, those who are viewers, will be the ones who will pay the price. And, according to the Wall Street Journal, the industry thinks that this is very desirable because the idea of controlling an idea from its appearance in a book or magazine, its debut on the big screen or on television, and its exploitation in video cassettes and cable and syndication and spin-offs and sequels. They want to have the whole ballgame going, and frankly they are moving very effectively to achieve just that objective.

Have conditions changed to warrant less concern with separating the content from the conduit? I think the answer is very obviously no. What we have to do is take a look at cable.

I want to commend the Chairman, I might say, because I looked at your list of witnesses; you could not have brought together a more important list of players in this industry than you have appearing before you. And I think it is probably the greatest accumulation of the industry, across the board, that I have ever seen coming before any Congressional committee. And I think it is a great achievement on your part.

And I think it is also an achievement that you have got, in most instances, the number one person, not one of the persons just coming forth as a spokesperson.

We have to recognize that this failure to have any effective regulation, any effective competition, winds up with the American consumer not being able to be certain what is going to happen next.

We know what is happening with the New York Yankees situation. We know of the fact that they are available on pay television. And frankly, there are many of us, and we have spoken often and we have had hearings on it in the Antitrust Subcommittee, as to the question of whether we are going to get to the point of having pay football and pay baseball across the country. We get assurances no. But, then, all of a sudden we see George Steinbrenner's deal with MSG, which, if my recollection serves me right, I think it is one of the subsidiaries of Paramount. It is one of its subsidiaries.

I have a bill before this Committee that will authorize rate regulation unless a city is served by another cable system or some other comparable multi-channel provider, like wireless cable.

But wireless cable has a tremendously challenging problem facing it because those who own the product have been in my office and said, well, we do not sell it to them because they cannot pay their bills. And so I said, well, why do you not get a letter of credit? Why do you not get some assurance that they will pay their bills?

And maybe because of the questions we have asked, there has been the slightest breakthrough as to making product available from HBO, for example, Time's subsidiary, to some of the wire-less operators, but it has not been a general policy.

My bill, S. 833, which I believe is supported by some members of this committee, tries to deal with this problem.

Unfortunately, in this area, Mr. Chairman, and members of this Committee, the Justice Department has not done much. They turned their back on the Time-Warner merger, and I am not sure what they will do with respect to the Paramount merger. But, so far, they have not seemed to take much of an interest.

As a matter of fact, I wrote to the Justice Department raising some of these questions in connection with the Time-Warner merger. I think Viacom subsequently filed a suit against Time. But the Justice Department is not listening and you have still got this vertical integration; and some of your witnesses today are doing a magnificent job of dominating the industry: buying into the production companies, going out and saying to little cable operators, "We will take over the selling your programs, and we will help you with respect to obtaining product."

And so even though they do not own the smaller cable companies, they are using their tenacy and their strength to move on them. I think this trend will continue and have an increasingly negative impact upon the consumer unless this Committee or the Justice Department does something about it.

The cable operators now control most of the popular cable programming services. As a matter of fact, I am told that if you have a new program and you want it to be on cable, you must meet with the top six cable owners in this country—they can either give you the go ahead or tell you forget about it. And if they give you the go ahead, you are in business, your product is going to be carried. But if they say no, you may as well forget about it because no matter how good it is, there is not going to be enough opportunity to sell it at any place whatsoever.

I am trying to shorten this because I know you have got other witnesses.

We cannot overlook the fact that some programs cannot be obtained from any source other than cable. So when Senator Packwood talks about the news, yes, indeed, you can get the news, but you cannot get the kind of programming that cable is able to provide.

Cable is now so strong that in some instances, one instance in my own state, they just told a television station, you cannot be on the cable; which practically destroys that cable station entirely. That is not the only instance throughout the country.

They have the power to say, "We are not going to carry you." If they do not carry you, that makes that regular television station totally unable to compete in the marketplace, totally unable to sell its product.

I have another bill before your Committee that will require vertically-integrated cable programmers to make their programming available to alternative technologies.

I believe that Senator Pressler has a similar bill, and Senator Gore, I do believe supports it. I think I misstated—my staff just advised me that that one is not before your committee; that bill is before my own committee.

In conclusion, let me say, Mr. Chairman, and members of this Committee, the cable experience shows conclusively the validity of congressional concern in this area. If we do not act, it is going to be too late to act. And Congress cannot afford to sit idly by and look at the faits accomplis that we are presented with, frankly, every day of the week.

And I believe that if we are going to make available a totality of media and entertainment facilities to the people of this country, then we are going to have to see to it that there is a continuation of the competition which heretofore existed in this industry, but is gradually being eliminated as more and more concentration occurs.

Mr. Chairman, I would ask that my entire written statement be included in the record, if I may.

Senator INOUYE. So ordered.

[The statement follows:]

STATEMENT OF HON. HOWARD METZENBAUM, U.S. SENATOR FROM OHIO

Mr. Chairman, I want to commend the Commerce Committee for holding hearings on the vital topic of concentration in the media and entertainment business. These issues are also of special concern to the Judiciary Committee's Antitrust Subcommittee, which I chair.

The fight for control over Time, Inc. between Time-Warner and Paramount make these hearings particularly timely. These companies are spending billions of dollars trying to gobble one another up. Wall St. loves it. The press is enthralled. But the bottom line for consumers and the creative community is the same, regardless of whether the new company is Time-Warner or Time-Paramount: Increased concentration in the media and entertainment business. That raises the threat of less diversity and higher prices to end users: Book and magazine readers, moviegoers, and cable subscribers.

The Time-Warner-Paramount wrangle is rooted in a conviction among analysts and executives that the communications industry of the future will be dominated by just a few large vertically integrated global media giants with control over all the phases involved in disseminating information and entertainment to the public—creation, production, and distribution.

Until recently, public policy in this area sought to separate control over the creation and production of information and entertainment from control over the distribution of that information and entertainment. This separation of content from conduit was embodied in rules preventing the motion picture studios from owning theatre outlets ad the FCC's 1970 financial interest and syndication rules, which limit the three television networks' ability to own and produce broadcast television programming. In addition, rules limiting cross-ownership of different forms of media—broadcast-cable, newspaper-television—also are designed to restrict concentration and promote diversity.

Increasingly, restrictions on ownership in the media and entertainment business have come to be viewed as outmoded and a hindrance to success in the new global communications market. Ironically, the vertical integration of content and conduit—regarded as a danger in the past—is now touted as the key to success in the communications industry of the future. The synergies hailed by media moguls and industry analysts studying the Time-Warner-Paramount dispute revolve around one company's ability to, in the words of the Wall Street Journal, "control an idea from its appearance in a book or magazine, its debut on the big screen or on television, [and] its exploitation in videocassetes, cable, syndication, spinoffs and sequels."

It's not hard to imagine how this kind of synergy can help a company's bottom line. The question which we here in Congress must ask is whether conditions warrant lessened concern for separating content from conduit. I think the answer is no.

That answer is based, in part, on my assessment of the cable industry. The cable industry has faced no restrictions on its ability to control both content and conduit and it also has enjoyed the singular benefit of reaching its maturity in the Reagan era. In recent years, industry oversight has been left to a group of zealous deregulatory ideologues who chafed at the thought of dealing with cable's monopoly power.

In 1985, the FCC developed an absurd definition of effective competition which holds that three moderately fuzzy over-the-air television channels effectively compete with the vast array of programming available via cable. This definition has essentially precluded rate regulation nationwide, while doing nothing to restrain the prices which cable operators are charging their customers. I introduced a bill, S. 833, early in this Congress which legislates a definition of effective competition which is far more reflective of the realities of the cable market than is the FCC definition.

One thing that puzzles me Mr. Chairman is that the FCC has been leading the charge to allow the telephone companies to provide cable service, with its outgoing chairman arguing that the cable industry needs a shot of competition. Now I don't want to debate the merits of Telco entry into cable, I just want to ask a simple question: What happened to the idea that three TV signals compete with cable? Why is the FCC saying cable needs competition when its policies say cable already faces competition in every part of the Nation except the most remote rural areas? If the FCC's notion of competition is broke, then it ought to be fixed before the Commission starts asking Congress to set sail for new uncharted waters.

The Justice Department hasn't been much better. At about the same time the FCC determined that cable was competitive for regulatory purposes, the Justice Department decided not to challenge mergers in the industry on the grounds that cable was a natural monopoly. The happy result for the cable industry was that it was subject to neither antitrust nor regulatory oversight.

The Justice Department had a chance to make amends a couple of months ago, by carefully scrutinizing the Time-Warner merger. It failed. I wrote the Department a letter urging them to recognize that, for antitrust purposes, the "relevant product market is the local market for cable television." The Department obviously regarded the industry as perfectly competitive since the merger sailed through without resistance. Yet little more than a month after the Department concluded that the Time-Warner merger posed no competitive problem, Viacom, one of the most significant vertically-integrated players in the industry, filed an antitrust suit against Time.

The complaint stated that "geographically, each cable television market is local . . . [and] each cable operator is a monopolist in its local market."

Mr. Chairman, such nonexistent antitrust and regulatory oversight affords us a chance to examine what happens when a significant sector of the media business is given unfettered discretion to control both the content and the conduit of information and entertainment. The results are not pretty.

You will recall, Mr. Chairman, that in 1974, President Nixon's White House Office of Telecommunications Policy recommended separating control of cable distribution facilities from control of cable programming. That recommendation was ignored, however, with the result being that the large multi-system operators now control most of the popular programming shown on cable.

Mr. Chairman, decisions about the kind of programming which viewers see and the terms on which it is available should depend chiefly on whether there is an audience for the programming. These decisions should not be dictated by whether or not the cable industry has or will have a piece of the action. Unfortunately, cable programming decisions have been infected by an operator's program equity interests. A number of lawsuits have been filed against the large vertically integrated MSO's, alleging anticompetitive discrimination against unaffiliated programmers. Since must-carry rules were invalidated in 1985, hundreds of local broadcast stations have been dropped or denied carriage by cable systems. In most instances, the stations were replaced with programming in which the operator had a financial stake.

Last year, sports fans in the New York area learned first-hand the dangers of vertical integration in the cable industry. Cablevision, a New York area cable operator which owns Sportschannel, dropped a competing sports channel, MSG, after a dispute over tiering. MSG was carried on the basic tier by every other cable system in the New York area, but Cablevision refused to follow suit. The reason: Carrying MSG on basic would have cut into the revenues of Sportschannel, which cablevision carried on a pay tier. The result: Legions of fans in the New York area went without Knick and Ranger games for months, and are currently being denied access to Yankee games.

While vertical integration clearly infects the process of deciding which existing program offerings should be carried on an operator's system, the impact on new programming is more subtle. There is widespread consensus that no new cable programming venture can survive without the go-ahead from large multi-system cable operators. Last year, in testimony before the House Subcommittee on Telecommunications and Finance, Jack Valenti of the Motion Picture Association of America indicated that some programming ventures never saw the light of day simply because the cable industry does not want noncable program suppliers.

Perhaps the cable industry's reluctance to embrace new noncable program suppliers is rooted in its desire to privilege one form of multichannel program delivery—coaxial cable—at the expense of alternative distribution technologies. The industry's control over the most popular cable programs has stifled the emergence of other program delivery technologies, such as backyard dishes, wireless cable, and direct broadcast satellite. These noncable technologies, which were touted as direct competitors to cable when deregulation was being considered, have now been relegated largely to servicing unwired areas. A key reason these noncable technologies have failed to emerge as direct competitors has been their inability to get programming on fair terms and at nondiscriminatory prices. The result: Consumers who want multichannel programming have to get it via the transmission technology which most benefits the cable industry. I have introduced legislation, S. 834, designed to help remedy this situation. My bill would require vertically integrated cable programmers to make their programming available to competing technologies on fair terms and at nondiscriminatory prices. The bill also places limits on horizontal concentration in the cable industry similar to those imposed on the broadcast industry.

Mr. Chairman, vertical integration in the cable industry illustrates the kind of synergy being hailed by analysts and executives. But the cable industry example also demonstrates the validity of the concerns which underlie Government policies separating the control of the content of information and entertainment from the control of the conduit.

Mr. Chairman, I am concerned that these policies are being swept away without examining whether the integration of the components involved in creating, producing, and distributing information and entertainment won't result in narrowing the range and depth of information and entertainment available to people. I'm concerned that these large global communications giants will put a premium on safe, homogenized information and entertainment products which are not strongly rooted in a particular culture or region, in order to facilitate distribution in a broad range of countries. And I am concerned that increased vertical integration between production studios and cable operators will reduce the amount of new programming that goes to free television, creating a gap between information haves and have-nots.

If we need to do anything Mr. Chairman, we need to limit the ability of the cable industry to control both programming content and program distribution to subscribers. We need to correct abuses of monopoly power in the cable industry, rather than have those abuses serve as a justification for accelerating concentration and vertical integration in the media and entertainment business as a whole.

Senator INOUYE. Senator, I realize you have to be someplace else to be chairing your own hearing. We have heard much about your Antitrust Subcommittee hearings, and if you will do us the favor, I would appreciate it, can you share the transcript of your proceedings with us?

Senator METZENBAUM. We would be delighted to do so. And I would say to you without any reservation, we feel that our efforts and your efforts work together, go along the same path, share the same concern. I certainly will make it available to you, and I want to say to the chairman, if in any way our subcommittee can be cooperative, please do not hesitate to call upon me, because I assure you that we will cooperate.

Senator INOUYE. Thank you very much.

Senator Gorton.

[No response.]

Senator INOUYE. Senator McCain.

[No response.]

Senator INOUYE. Senator Gorton.

[No response.]

Senator INOUYE. You gave us all the answers.

Senator METZENBAUM. That is all right. No more hearings. Thank you very, very much.

Senator INOUYE. Our first panel consists of the chairman of Tele-Communications, Incorporated, of Denver, Colorado, Mr. John Malone; and the President of WPSD-TV of Paducah, Kentucky, Mr. Fred Paxton.

Gentlemen, we are extremely grateful to both of you for taking time from your extremely busy schedules to testify before this subcommittee.

Mr. Malone, we look forward to your visionary words. As one of the pioneers and one who has innovative ideas about where cable should be headed, it is a great pleasure to have you here with us.

STATEMENT OF JOHN C. MALONE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TELE-COMMUNICATIONS, INC.

Mr. MALONE. Thank you, Senator.

I will try and keep my remarks brief.

We have filed some written testimony that I think is fairly complete and elaborate.

Senator INOUYE. May I assure all the witnesses that their prepared statements will be made part of the record.

Mr. MALONE. Perhaps I can best summarize by going through my personal experience in the industry.

I have been in the cable industry now for about 20 years; it seems like a lifetime. When I joined the industry, cable service primarily consisted of rural delivery of broadcast signals. The average cable system had about a 12-channel capacity; carried about seven signals, almost all of them broadcast; charged about $6 a month for the service; and represented a capital investment for a subscriber in 1970 dollars of $300 in capital.

The industry struggled for years, at various times, with inter-industry conflict. When the stationary satellite came along in the mid-1970s, it revolutionized the scale economics of national delivery of video programming.

And really the industry blossomed from that point, I think, nurtured by the FCC to some degree and at various times by the Congress in areas where it felt that the industry was being stifled in its natural evolution.

The industry grew reasonably well.

The charge, as we understood it, was to create diversity, to create choice, to literally survey our subscribers and find out what it is that we can give them that they do not receive that they like, and try and arrange, to create, and/or deliver that incremental service, and build a business on it.

In 1984 Congress passed a cable act that, in effect, for the first time gave us a national communications policy for cable. We do not view that as having deregulated cable; we view that as having essentially separated the regulatory process, leaving with the local communities a broad array of regulatory responsibilities and moving to the FCC, in effect, the issue of rate regulation.

Since that act, cable has blossomed. While our rates have gone up for basic cable, our rates have gone down for the premium services. But, by and large, statistically, we feel the cable industry has behaved in a very sensible way with its new-found flexibility.

In our particular case, our cost of programming has been the principal component driving rate increases, other than inflation.

I might say that, at this point, we serve an average of 42 channels for $15. So, in effect, in 20 years we have gone from six or seven channels for $6, $1 a channel—none of which were created by the cable industry or paid for by the cable industry—to a situation where we offer about 42 channels for $15. Inflation during that period has been about 400 percent, about 4 to 1.

So if we just look at inflation, we would be at $24 on basic.

And, of course, our programming costs, which in those days was nil, now represents about 20 percent of our revenues and, in fact, is the greatest pressure on basic subscriber rates.

So we feel that the flexibility of the industry has created a lot of diversity and programming offerings. All of our surveys indicate that the subscribers are very happy with the product, with the programming.

In virtually all categories of programming with the exception of local news, cable subscribers regard cable programming as superior to broadcast programming.

With respect to issues of media concentration, when I entered the industry, it might be of some interest that the Bell system was the largest provider of cable service in the country. Basically, the government kicked them out of the business about the time I was coming in. They frankly did not do a particularly good job.

Through the years, we were a very small company. Our goal was to build a business. We have never paid a cash dividend. We reinvest every dollar that we generate in internal growth.

The cable industry generally has the lowest return on invested capital of any media business. Broadcasting, incidentally, has the highest return on invested capital of any media business.

We have tried, essentially, to satisfy our constituencies, primarily our subscribers. The growth of the industry I think indicates that the public likes the services and, by and large, is delighted with the programming fare that is being provided. That is really why cable penetration is accelerating. People vote every month with their subscription payments. And cable is accelerating, in terms of its penetration and acceptance, not decelerating.

Both our company, and I think generally, the industry, have tried to negotiate with those industries in which we come into conflict in order to minimize confrontation and maximize cooperation. And I am sure we will get into that.

We believe, for instance, that broadcasters are entitled to a must-carry provision. We, and many others, are concerned about the vertical integration going on, for fear of how it affects us. We are basically a purchasing agent for our subscribers, and we try and conduct ourselves so as to give our subscribers the best long-term deal.

I might say, in that regard, that our average bill to our subscribers is 49th out of 50th of the largest MSOs. So we really deliver, in terms of our cost-effectiveness.

We basically run that way. And I think, probably, I am better off responding to questions, Senator.

[The statement and questions and answers follow:]

STATEMENT OF JOHN C. MALONE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TELE-COMMUNICATIONS, INC.

Mr. Chairman and Members of the Committee, thank you for asking me to share some of my views about the current status of the television business from a cable operator's perspective and some thoughts about trends that will influence television in the 1990's.

To fully understand the changes taking place will take long and careful analysis by the Committee and its staff. Certainly neither Mr. Paxton nor myself have all the answers. You will need substantial input from segments of the video communications business who chose not to attend today, but we are happy to help the Committee begin its task.

Fifteen years ago, no one would have thought to ask a cable executive to testify about the future of video communications in the United States. At that time, the three major networks dominated television, and most Americans thought television meant the sometimes fuzzy, off-air reception of local network affiliates and two or three other broadcast stations in some markets. While it is true cable had millions of subscribers at that point, most lived in small, rural communities, and cable was still predominantly a retransmission mechanism providing clear reception of local television stations and a few other stations from the nearest big city.

By 1975, some cable pioneers, including Bob Magness, the Chairman of my company, had been hard at work in the industry for almost 20 years and they had little to show for it except red ink on their financial statements and slivers from climbing too many poles.

Now, as we approach the beginning of the next decade, we can look back on 15 years of furious activity in the cable industry that transformed the nature of the television business forever. Viewers now have more choices, better pictures and better quality programming at a cost, in TCI systems, averaging less than a penny and a half per channel per day for basic service and the equipment needed to receive it. There can be utterly no question that the television viewer is better off today than he or she was before cable became a viable business.

The fact that extraordinary changes have taken place in the video communications business should not be startling. Television, both broadcasting and cable, uniquely demands enormous amounts of creativity — artistic creativity from its programmers, technological creativity from its operators and engineers and business creativity from its executives who, from the outset, had to deal with large, well-entrenched competitors and suppliers. Creativity breeds change, and the only certainty in our business is that of failure for those who cannot or will not keep pace.

Today, I would like to first discuss, by way of background, a few of the strategic principles which cable has embraced during its brief history. Then, I would like to turn to some of the trends that will influence television in the 1990's and the challenges they pose for us all. Finally, I will close by offering some thoughts on how the cable industry might contribute to peace in the video communications industry during the very important decade that is to follow.

On its way to becoming the successful, maturing industry that it is today, cable has become an agent for change in television by aggressively pursuing a number of strategic objectives which remain central to our business today.

The first is to provide more television choices to the American consumer. In 1975 there was only one cable network, HBO, seeking access to cable systems in our country. By 1990, that number is expected to reach 110. That prodigious growth has occurred because cable operators have consistently encouraged programmers to develop quality programming that appeals to selective niches in the marketplace where our research indicates there is a demand. Cable consciously rejected the broadcast network concept of mass appeal programming which must accommodate the viewing habits and tastes of the lowest common denominator.

The number of such marketplace niches that creative genius has moved to fill is large, including movies, both new and old, nature, the arts, education, Black and Hispanic entertainment, religion, sports, news, professional development, the Congress, popular music, country music, children's programming, weather, travel, the hearing impaired, home shopping and many others. Each time the list appears complete, a new programming idea appears to compete for channel capacity, such as the recent proposals for a comedy channel.

In surveys, subscribers tell us the diversity and variety of cable programming is the most important reason they subscribe to cable. The appeal of such a broad range of channels has led one of your colleagues recently to declare on a network news show that cable is a "psychological necessity." Few of us in the industry would go that far, but clearly we have reason to be satisfied with our strategic emphasis on niche programming which yields many more consumer choices.

The second strategic objective cable has pursued aggressively is to improve not just the variety, but the quality of cable programming. Here, too, there is dramatic evidence we have succeeded. Earlier this year, the National Association of Broadcasters released a Roper Poll in which the public rated cable programming higher than network programming for all categories mentioned, except for local and national news. Cable was rated better in children's and education programming, sports, culture and movies. For local news, the broadcast stations were much higher, since most cable companies are just now exploring that programming possibility. For national news, the figures were much closer.

Interestingly, when TCI subscribers were asked in our own independent, professional telephone polls "What is your favorite network for national news, ABC, CBS, NBC or CNN?", they responded as follows:

	1989	1988
ABC	18%	18%
CBS	18%	22%
NBC	20%	20%
CNN	30%	31%
OTHER	14%	10%

These numbers show that Ted Turner's Cable News Network (CNN) has made enormous strides in its competition with the network news shows. (The alleged impact of "favored channel position" would not be a factor here, because in virtually all TCI systems, the network affiliates are carried on channels 2-13 and CNN is often carried above channel 13.)

The same sample of TCI subscribers, when asked their agreement/disagreement with the statement, "The programs on cable are better than the programs on broadcast networks," responded as follows:

	1989	1988
Strongly or somewhat agree	54%	53%
Don't know or neutral	19%	17%
Strongly or somewhat disagree	27%	29%

Obviously, there has been an improvement in the quality of cable programming, and our subscribers have noticed the difference.

Just as clearly, the improvements have not been achieved inexpensively. According to leading industry analyst, Paul Kagan, the basic cable networks will spend $935 million for programming in 1989, up from about $745 million in 1988, and nearly triple the $340 million spent in 1984. When all forms of programming are taken into account, cable operators likely will spend in excess of $2.5 billion in 1989 for programming.

At TCI, our costs for basic programming have escalated dramatically over recent years, as indicated by the chart below:

AVERAGE ANNUAL TCI BASIC PROGRAMMING COST INCREASES, INCLUDING COPYRIGHT FEES*

1986	31%
1987	34%
1988	34%
1989	48%
TOTAL 1985 - 1989	248%

*Figures for each year are based on increases from previous year. The total figure for 1985-89 uses 1985 costs as base year.

TCI has been willing to pay higher license fees for cable programming where improvements in quality appeared likely to occur. On a few occasions, we have agreed to renegotiate existing contracts where a particular network has made a good case that improved quality will result. To date, we are satisfied that our subscribers are receiving a higher value product in return for our payment of rapidly escalating license fees.

However, in at least one area, that of sports programming, there is a need for caution. At the beginning of this year, I made known our concern that frantic bidding for certain sports rights could result in a programming investment that could not be recovered fairly or practically from basic cable subscribers. Not all of our subscribers are sports fans, and not all are willing to pay sharply higher cable rates for sports rights contracts that are too high. In cases of clear abuse, TCI would consider taking a service out of the basic cable package, lowering basic cable rates and offering the service as a low price, optional channel for those who want it.

I know there is substantial concern in the Congress and elsewhere about the potential migration of sports programming from broadcast television to cable. My view is that major sporting events, such as the World Series and the Super Bowl, will always be on broadcast television. These events can be adequately supported by advertising revenue alone, and I would strongly oppose any proposal to bring events of this nature exclusively to cable.

Moreover, I believe the number of local regular season professional football, baseball, and basketball games, as well as local college sports events broadcast over-the-air, will remain about as it is now, unless the teams totally lose control of their costs. Once again, there appears to be adequate advertising revenues under current circumstances to support broadcast of these games.

Cable's role in sports coverage should be to add to the number of games available on television, to provide more in-depth coverage of a particular sport, or to provide coverage of the less popular sports that cannot command sufficient advertising revenues to be viable on broadcast television.

ESPN's Sunday night NFL games are a perfect example. ESPN has added to the total number of NFL games on national television and given viewers another option for when they want to watch professional football. Moreover, the additional revenue from ESPN enabled the NFL to continue its Monday night games with ABC, which have become an American institution.

The third strategic objective cable pursues is to provide better pictures and more consumer friendly equipment to our subscribers. In 1975, the state-of-the-art cable system could provide a bandwidth of 300 MHz and 35 channels. In 1985, the figures had risen to 550 MHz and 75 channels. Now, under development is coaxial cable technology to achieve even higher bandwidths during the 1990's. Moreover, the dramatic increase in the use of fiber optic cable for trunking purposes will increase the capability of our systems substantially, and will produce better pictures, especially for subscribers in sections of the cable system that are far removed from the headend.

Converter boxes are improving, and cable systems are becoming more compatible with VCR's and cable-ready television sets. At TCI, we have always believed that all the channels a consumer purchases should be descrambled by a device outside the home, so that the subscriber could use cable in any room and with any equipment he or she chooses without a set-top converter. We continue to work on the equipment necessary to achieve that goal.

Given the capital intensive nature of the cable business, all of these improvements have required enormous expenditures on plant and equipment, and, more importantly, a management philosophy which sacrifices short-term profits for longer term benefits.

Like many other cable companies, TCI pays no dividends to its shareholders. By plowing cash generated from our operations back into the business, we can promise shareholders long-term appreciation in the value of their shares. At TCI, that management philosophy has worked well. A share of TCI stock bought for $1 in

1975, which was, in fact the selling price at one point during that year, is worth about $800 today.

In 1989, TCI's capital costs will be around $390 million. Most of this money will be spent on rebuilding and replacing cable systems since all but one of our new-builds is winding down.

During the 5 years from 1984 through 1988, TCI's capital expenditures were about $1.2 billion. During the same 5 year period, we reported earnings of about $160 million.

A fourth strategic principle the cable industry has followed — one that could be important in the next few years — has been to enter into compromises in the public policy arena in order to achieve some stability in its regulatory environment. Throughout its history, the industry has been the target of debate in Congress, the Federal Communications Commission and other agencies of the Executive Branch. Moreover, numerous court decisions have influenced events, including a few by the Supreme Court. Much of the controversy was sparked by conflict with the broadcasting industry.

However, in at least two critical instances, cable was wise enough to compromise with its foes in order to achieve a measure of business stability. The first of these occurred in the 1970's after the Supreme Court, in the Fortnightly case, had overturned lower court cases making cable systems liable for copyright infringement for the broadcast signals they retransmitted. Industry leaders recognized there would always be conflict over copyright issues as long as cable was selling the creative product of others without having in place a fair mechanism for compensating programming rights holders. Inter-industry discussions finally yielded a compromise which, in turn, resulted in passage of the 1976 Copyright Act. With passage of that Act, cable was able to secure what was then the core of its business, the retransmission of broadcast stations, and enter the age of satellite-distributed programming with its base intact.

The second critical compromise was the Cable Act of 1984. By agreeing to recognize the right of cities to franchise cable operations, to collect a franchise fee of up to 5% of gross revenues and to secure a host of other advantages in the franchise process, cable got, in return, a reasonable expectancy of renewal and deregulation of its rates in localities where there was "effective competition" as defined by the FCC. Although the price was great, the Act allowed cable to escape from a system of municipal rate regulation that was onerous in the extreme in many cases. Between 1976 and 1986, before rate deregulation was implemented under the Act, cable rates had been allowed to increase by only 65%, while inflation indices increased 93% during those 10 years.

As expected, cable rates increased in 1987 and 1988 after deregulation, as companies sought to compensate for years of overly-strict local rate regulation. NCTA figures show average annual rate increases in 1987 of 6.6%, and 1988 of 7.9%. However, it is now clear this "catch-up" phase is over. Cable rates have increased at less than the rate of inflation for the first quarter of 1989.

TCI has announced that except for unusual local circumstances, its rate increases for the foreseeable future will not exceed the inflation rate. We have, however, reserved the right to recover certain programming cost increases to the extent they exceed inflation.

The chart below details TCI's average basic cable rates from 1984 through 1989 (est.):

1984 - $ 9.92
1985 - $11.01
1986 - $11.65
1987 - $13.24
1988 - $14.23
1989 (est.) - $15.97

It is important to recognize that when the Cable Act's deregulation provisions took effect, TCI stopped charging a monthly fee for additional hook-ups within the home in most systems and began providing a converter box for free on non-cable ready first sets. Since these fees were sometimes in excess of $5.00 a month, many subscribers in TCI systems actually paid less in the months following deregulation. This is one of the important reasons why TCI is 49th on a list of 50 top MSO's in monthly revenue per subscriber, according to recent Paul Kagan figures.

Since passage of the Cable Act in 1984, 44 new cable programming services have been started, and typical cable systems around the country now offer from 30 to 53 channels. Before passage of the Act, systems typically had 24 channels or less. The number of cable subscribers has increased from about 30 million in 1984 when the Act was passed to about 45 million today.

I think it is instructive for those of us in the industry to remember that compromises on public policy issues, like those mentioned above, may well be very expensive and painful in other respects over the short-term, but inevitably the stability that results helps us focus our efforts on the mechanics of running our businesses and competing in a changing business environment over the longer run.

Now, I would like to spend a few moments talking about some of the trends I see developing in the video communications industry, and about my company's response to them.

First, I think there will be more blurring of the lines between industries that are involved in the television business. Two of the three major broadcast networks already own several cable networks, and we are hopeful the third will get involved, as well. Motion picture studios own three cable networks, and we now read that the largest, Paramount, wants to buy Time, Inc., which has both cable networks and substantial cable system operations. Local broadcasters are ideally suited to provide regional news and features on cable, and we have already begun very preliminary talks with some who have said they might be interested in such a venture.

Broadcast-cable cross-ownership rules and broadcast network financial interest and syndication rules are currently under review, and a relaxation of either rule would accelerate the blurring of lines among industries involved in the television business.

For its part, TCI's plans are less grandiose than some. We are, first and foremost, cable operators. We intend to develop that business the best we can by staying abreast of technological developments, controlling our costs, providing improved customer service, providing a variety of high quality programming and charging our customers reasonable rates.

Much of the early debate on vertical integration issues generated by the motion picture studios and independent broadcasters focused on programming investments by cable operators. Now that the studios and the networks have made or are proposing enormous investments in cable programming and operations, I believe future debates will have a more accurate perspective.

Only three cable companies are vertically integrated in a classic sense, insofar as they seek to own and control programming interests, and TCI is not among them. Our company has made limited programming investments (See Table 1), but we do not seek to be a programmer, nor do we intend to develop the creative expertise in our company to be a programmer. We have no financial or managerial control over any national cable programmer in which we have invested, and our investments are primarily passive. (TCI does have interests greater than 50% in a few regional cable services.)

We have invested in programming and will continue to do so only under limited circumstances. First, TCI will always be conscious of its programming costs, since they directly affect subscriber bills. Thus, when a cable network, particularly one that is the dominant supplier of a certain type of programming, loses control of its costs and seeks inordinately high license fees, we reserve the right to encourage the formation of a competitor. No one company in the cable industry can guarantee the success of a cable channel, but under these circumstances, we may have an obligation to do our best to encourage competition. That could well mean putting some of our capital at risk in the form of a minority investment in a new venture.

Second, we will continue to look for attractive niche programming that cannot be financed conventionally and serves an important public policy interest. Our minority investments in Black Entertainment Television and The Discovery Channel, and our affiliation arrangements with C-SPAN and The Vision Interfaith Satellite Network (VISN) fall into this category.

Third, TCI has sought to maintain the independence of key cable programmers through investments with other operators in the industry where such a programmer finds itself in financial difficulty. The only example in that category is the minority investments we and other cable operators made in Turner Broadcasting. Most of you are aware that Ted found himself over-extended two years ago and was threatened by parties whom we felt did not have the best interests of cable at heart.

Mr. Chairman, it is important that you, Committee Members and Staff have the distinctions I have outlined above clearly in mind as you make your way through issues related to the blurring of lines among various segments of the television business and vertical integration. It is important that cable operators retain the flexibility to encourage competition among their program suppliers, where necessary, to support niche programming that has a strong public policy component or audience appeal, and to save key elements of the cable programming industry from falling into hands of those who may not support strong cable programming. However, we do not seek to control programming in a conventional sense or actually become a programmer.

A second major trend I foresee in the next decade is a substantial slow down in horizontal concentration within the cable industry. Like the maturation process in other similar industries, there has been an emergence of larger companies, like TCI, as "mom and pop" retire and sell to the highest bidder. In addition, a number of profit-driven companies have left the industry as it became apparent that bottom-line earnings would be minuscule for the foreseeable future.

The trend toward consolidation will slow down not because there are fewer potential buyers, but because fewer are willing to sell. Most of us left in the industry are in it for the long haul, and are committed to developing the assets we now have to their fullest potential.

Current industry concentration figures should not be a cause for concern. Market share computations for cable MSO's fall well below the level the Justice Department traditionally considers unacceptable. TCI, the largest MSO, owns systems with about 7.5 million subscribers. 3.6 million of these are in systems managed by TCI, while the remaining 3.9 million are in TCI-owned systems managed by others. Thus, TCI's market share is about 17% of the 45 million cable subscribers nationwide (See Table 2). When all companies in which TCI has even a small minority investment are included, subscribers figures total slightly over 11 million.

A third trend I see taking place, in general, over the next decade is an increasing emphasis on customer service issues. I can tell you that no single issue is getting more attention in my company than customer service. Now that we are approaching the end of the large capital expenditures we have had for new construction, and most of the country that can economically be wired for cable is wired, we have the opportunity to make significant improvements in this area.

Analyzing the situation that now exists is not as easy as it might seem. To start with, subscriber polls done for TCI by outside professionals indicate subscribers have high general satisfaction levels when asked about cable TV service generally. 1989 figures are as follows:

Very satisfied	24%
Somewhat satisfied	56%
Neutral	2%
Somewhat dissatisfied	15%
Very dissatisfied	4%

Some of the more detailed questions dealt with technical quality of cable service, the billing process, and our customer service over the telephone.

When asked about the "technical quality" of their cable service, which was defined as "picture quality, lack of service outages, and the connection to and in your home", the response was as follows:

Very satisfied	39%
Somewhat satisfied	38%
Neutral	1%
Somewhat dissatisfied	16%
Very dissatisfied	6%

The figures for "providing accurate bills" were as follows:

Excellent	25%
Good	53%
Fair	13%
Poor	7%
OK	3%

The portions of our polls that deal with telephone service are extremely detailed and lengthy, and an appropriate analysis is complex. Our service is unique, since a television set is on in an average household 6 hours and 59 minutes a day. This compares to average usage of the household telephone of about 20 minutes a day. There is a better chance consumers will notice a temporary outage in the cable system and telephone the cable system to complain.

Moreover, when there is a problem with the cable television system, consumers can use the telephone immediately to call the cable company. If a backhoe or lightning cuts trunk lines to an entire area, a good many of our customers will be inclined to call all at once, which produces large peak loading problems for our telephone receive systems. Those problems are less acute in the telephone business, since household or area outages incapacitate the very device a consumer would use to report the problem.

Generally, our figures show subscribers are less satisfied with that part of our service involving telephones. When asked "How well (did) your local cable company handle your call," the figures were as follows:

Excellent	23%
Good	31%
Fair	23%
Poor	22%

The figures above are substantially biased toward the less satisfied categories, since usually only those who have problems actually call the cable system. Nevertheless, this question and other more detailed follow-ups are under close study, and we think they will provide guidance on how we can improve these numbers substantially.

Quite frankly, when we first looked at these numbers, we were surprised at their strength. However, an additional poll just completed for us by Brushkin and Associates in New York has provided an important clue about subscriber reactions to cable service issues. Results of that poll indicate that although a particular subscriber may be very satisfied with cable programming, an incident of poor service dramatically lowers his overall satisfaction levels. One would expect that result, but not nearly to the degree the poll revealed.

Given the importance our customers place on excellent service, I believe our entire industry is prepared to make enormous strides in this area as we enter the next decade. We will have more resources and much better equipment at our disposal. Moreover, we are determined at the highest levels to improve.

While I cannot give many details now, I can tell you that TCI will be making a major announcement about customer service in the Fall that we believe will set the standards in this area for the cable system of the nineties. It will involve a major commitment of resources by our company in a multi-faceted program that expands many of the procedures we have in place and initiates some new ones, as well.

Another trend that cannot escape notice will be the impact of high technology on television in the years to come. Fiber optic cable will quickly replace coaxial cable as the preferred medium for trunking in the cable industry. Cable companies have already deployed hundred of miles of fiber trunk and the rate of installation will increase dramatically. During the lifetimes of most of us, wireline video signals to households will be delivered by a cable system employing fiber trunking and coaxial cable drops into the home.

Telephone company proposals to combine incompatible system architectures and switching requirements of telephone and commercial television transmissions into a broadband fiber service into the home are not practical for the foreseeable future. The inefficiency, complexity and astronomical cost of such a system would make it economically infeasible and uncompetitive without substantial subsidy from telephone rate payers.

High definition television ("HDTV") has caught the fancy of many who study the future of television. We should be very cautious as we move into the era of HDTV not to let enthusiastic policy-making exceed consumer demand for HDTV, which may or may not exist. Both cable and broadcast must work together with government to get a clear initial picture of how much extra consumers will pay for improved television pictures.

I will say that digital transmission of video signals does appear to be a reasonable goal for the Twenty-first Century. Assuming proper marketplace studies are done, TCI believes the United States should adopt a national policy to leapfrog foreign competition and to develop a digital video transmission standard for the first decade of the next century which can be used by both broadcast and cable and which is capable of producing 35mm quality pictures on large television screens. Such a project will require major funding for research and development and wise leadership from the Congress and appropriate federal agencies. However, I am not at all sure that federal funding is necessary or appropriate for such an effort.

In the meantime, during the 1990's, we believe the United States can preserve its strategic position by embracing the much improved American analog technology available now. This technology can produce a better picture on existing sets, and a dramatically clearer and sharper picture on improved sets which will be only slightly more expensive than current sets. Moreover, the technology is compatible with our current 6 MHz, NTSC system. At least two American firms, Sarnoff Laboratories and Faroudja Laboratories, are already perfecting systems of this nature.

By squeezing the most we can out of our current transmission systems, we can devote more of our private and public resources to developing digital television and save our American TV viewers from switching to expensive new TV sets twice rather than only once.

The last trend I will discuss concerns the development of more competition among providers of multi-channel video services. We believe the next decade will see the home dish industry grow significantly. There are already 27 national or regional program suppliers that sell comprehensive packages of cable programming to the home dish marketplace. TCI, itself, sells a package of almost all cable programming that is scrambled plus all leading superstations for $11.50 a month, $5.00 a month cheaper than our basic service to cable subscribers.

Although equipment sales are somewhat stagnant now, we believe dealers who service the home dish market can look forward to a bright future as rural homeowners become more comfortable with the scrambling systems now being perfected and as signal piracy by the unscrupulous becomes less significant.

Likewise, the MMDS industry has testified in other forums that new equipment now available or being developed will solve the signal security problems that have plagued that industry in its infancy. Consequently, more programming should be available for MMDS distribution in the future.

Both these industries will provide an increasing level of service in rural areas and cable franchise areas, as well.

Finally, as I close, I would like to offer some general comments about the role I see for cable in the immediate future.

For more than half a century, the television broadcasting industry has provided an important public service to the American consumer, particularly by providing local programming to communities across the nation. Although broadcasters are cable's competitors, they are also our partners with interests identical to our own in many instances.

I believe cable must be willing to adjust the rules of broadcasters-cable competition from time to time in recognition of changing realities in the marketplace and in technology. Consequently, I favor reimposition of "must carry" rules and acceptance of an "on-channel" standard, where technically feasible, for broadcaster placement on cable channel alignments. Moreover, TCI has pledged to do its best to comply with the new syndicated exclusivity and network non-duplication rules promulgated by the FCC.

I think a similar spirit of compromise is appropriate in many other areas, as well. There should never come a time when cable refuses to talk or neglects to listen when others complain about being unfairly disadvantaged. To be sure, there have often been occasions when suppliers or competitors have sought unfair advantage in public policy forums. Cable still has an obligation to defend itself vigorously in those circumstances.

However, one of the consistent strengths of our trade association, the National Cable Television Association, has been knowing when to fight and when to make peace. I know that under the NCTA's current leadership, Mr. Chairman, you and Members of your Committee can expect a good faith effort on behalf of the NCTA to resolve any problems by private sector discussions where that is possible.

Thank you for your attention.

TABLE 1

TELE-COMMUNICATIONS, INC.

INVESTMENTS IN PROGRAMMING

	6/1/89 Percentage Ownership
American Movie Classics	50.0
Black Entertainment Television	14.3
COMB/CVN	20.0 (A)
Discovery Channel	36.4
Fashion Channel	43.6 (B)
Home Sports Entertainment	60.0 (C)
Netlink	80.0 (D)
Prime Time Tonight	35.0
QVC Networks, Inc.	20.8 (E)
Rocky Mountain Prime Sports Network	60.0 (F)
Think Entertainment	37.5 (G)
Turner Broadcasting	11.5 (H)

(A) Fully diluted. Includes ownership of UA (2.17%) and United Cable (1.95%)

(B) Assumes conversion of warrants. Includes 21.8% owned by United Cable.

(C) Owns 49% of Sunshine Network.

(D) Includes 40% owned by WestMarc.

(E) Fully diluted. TCI owns only convertible preferred and warrants. Includes United Cable ownership (3.68%).

(F) Includes ownership of United Cable (1/3 of 60% interest).

(G) Includes ownership of UA (12.5%) and United Cable (12.5%).

(H) Percentage of voting interest on a fully diluted basis.

TABLE 2

TCI SUBSCRIBER COUNT

Basic Subscribers

	12/31/88	Pro-forma Acquisitions and Consolidations	Pro-forma Subscribers
Consolidated:			
Managed by operating divisions	3,648,428		3,648,428
Managed by others:			
United Artists	880,065	1,113,589	1,993,654
Heritage	891,243		891,243
WestMarc	346,874	202,087	548,961
CSI	230,336		230,336
Bresnan	126,126		126,126
Others (3)	36,551		36,551
	2,511,195	1,315,676	3,826,871
Total Consolidated	6,159,623	1,315,676	7,475,299
Unconsolidated:			
Equity affiliates:			
Storer Communications	1,534,345		1,534,345
Daniels' partnerships	367,452		367,452
TKR Cable	269,726		269,726
Taft Cable	202,087	(202,087)	---
Heritage's partnerships	186,201		186,201
Kansas City Cable	145,041		145,041
Cencom Cable	133,909		133,909
U.S. Cable partnerships	62,053		62,053
Others (6)	83,015		83,015
	2,983,829	(202,087)	2,781,742
Cost investments:			
United Cable Television	1,113,589	(1,113,589)	---
Lenfest Communications	354,666		354,666
Columbia Associates	167,312		167,312
Cencom's partnerships	103,753		103,753
Mile Hi Cablevision	73,454		73,454
Others (12)	101,672		101,672
	1,914,446	(1,113,589)	800,857
Total Unconsolidated	4,898,275	(1,315,676)	3,582,599
Grand Totals	11,057,898	---	11,057,898

ANSWERS TO SENATE HEARING QUESTIONS

Q1. Looking at the U.S. market, should the market be defined as all video programming? Or should it be further subdivided into multichannel services and single channel services? What about pay services and advertiser supported services? Are these services separate markets?

A. It is well-settled, from both a legal and economic perspective, that market definition should focus on and reflect the practical impact on consumers.

Video programming is simply one means of conveying news, information and entertainment to consumers. A variety of delivery methods are utilized to deliver such programming, including cable, over-the-air television (VHF and UHF), wireless cable, direct broadcast satellites, multipoint distribution services, movies, and video cassettes. News, information and entertainment are also disseminated through other distribution methods such as print media (including newspapers, magazines and books), radio, records, audio cassettes, and various forms of live entertainment, such as concerts, plays and sporting events. Just as delivery methods vary, so do the specific content of a particular service and methods of financing (e.g., advertising-supported versus pay).

From the perspective of cable consumers, however, it is clear that all these choices represent alternatives to cable programming and thus exercise some degree of influence on the operation of the cable industry. While this may vary depending on the particular fact situation involved, all these options should be considered in defining a market and in analyzing competitive effects, and the appropriate market definition might well change depending on the particular conduct or transaction at issue. This is the consistent conclusion of courts, expert bodies like the FCC, and commentators who have reviewed issues of market definition involving the cable industry.

Q2. There appears to be a trend of programming migrating from over-the-air television towards cable. Why is this occurring and will it continue? Will local news be the next service to migrate to cable? If not, will this affect local television stations?

A. First, we disagree with the notion that "migration" or "syphoning" is taking place. Enclosed as an attachment is a study done by Prime Network that demonstrates contrary to the unfounded assertions of some, that in fact, there has been an increase rather than a decrease in the number of sports programs available on advertiser supported television since the advent of the regional sports channels.[1] (TCI has ownership interests in a number of regional sports networks including Prime Network.) We believe these networks will increase viewing options by resulting in more games being televised, more in-depth coverage, and permitting for the first time the carriage of marginal sporting events previously ignored by advertiser supported television because of narrow audience interests. Moreover, we believe that because of the substantial economies achieved by the major broadcast networks in efficiently reaching a national advertising audience that the major sporting events will remain on advertiser supported television for the foreseeable future. Recent developments with regard to the NBA-NBC and NCAA-CBS basketball agreements fully bear out this contention.

Second, we believe that there is a strong synergy between cable operators and local broadcast stations on a wide variety of areas that will enhance overall consumer welfare. We do not believe local news will "migrate" to cable. We are, in fact, encouraging joint ventures with local broadcasters to permit cable systems to increase the amount of local news available over cable. This will not result, however, in a reduction in local news availability over local television stations, but will merely enhance the amount of news over cable, and again will increase viewer choice overall.

Third, by supporting must carry of local stations even in the face of adverse court decisions, we have demonstrated our strong commitment to maintain a strong local broadcast industry responsive to the unique concepts of localism. However, we do believe that in the event the compulsory licence is eliminated there would be a substantial likelihood that all kinds of programs would migrate from local television towards cable. This would be true because increased local broadcast rights payments by cable would force a cable operator to make a decision as to the most economically efficient alternative to acquire programming -- whether to produce it or purchase is from third parties. The elimination of the compulsory license could well force a cable system to look elsewhere for the development of entertainment and news programming on an economically efficient basis. We wish to point out this is not a situation to which we look forward. We also do not believe it is inevitable. However, we do not believe that our subscribers are prepared to foot the bill for ever escalating programming costs, and that in order to keep cable rates from skyrocketing needlessly we would be forced to examine alternatives in the event local broadcast signals were made available under onerous terms and conditions.

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[1] The study was not reproducible.

Q3. In addition to having an equity interest in cable systems, does TCI act as an agent of other cable systems in the purchase of programming?

A. A subsidiary company owned by TCI, Satellite Systems, Inc. ("SSI"), acts as a buying agent for some, but not all of programming purchased by cable systems in which TCI has an equity interest. SSI does not act as a buying agent for cable systems in which TCI does not have an ownership interest. We are also aware that there are one or more "cable cooperatives", which are typically made up of small cable operators which act as a cooperative and buying agents for all of its members in the purchase of cable programming. We fully support their efforts.

Q4. What are the economies/synergies in operating multiple cable systems (horizontal integration)? Do these economies exist only when there is clustering of systems in a particular community? What are the economies/synergies in owning both the source of programming and the distribution outlet?

A. Like most industries, the cable industry is characterized by certain economies or synergies associated with greater size and the operation of multiple cable systems. These economics, which include cost savings and other improvements in administrative, servicing and marketing activities, vary both in terms of the manner in which the economies are achieved and the overall level of the savings. While realization of some economies is facilitated by the geographic proximity of cable systems, others do not depend on any type of clustering.

In considering the economies or synergies in owning both the source of the programming and the distribution outlet, it must be recognized that TCI does not own a majority interest in any national programming service nor does it have any day-to-day management control over the operations of any such programmer. Although TCI's primary business has been, and continues to be, the distribution of cable programming, it recognizes that this business can be facilitated by selective investments in cable programming. In competing with other forms of news, information and entertainment, the cable industry has found that one of the primary ways to attract and retain viewers is through the development of new and innovative programming. Such programming has been made possible, in large extent, by the investments of cable operators willing to incur the risks and significant costs of funding new and untried programming in the hope of discovering a particular program that meets consumer wants and provides a unique attraction for cable viewers. TCI's own investments in Black Entertainment Television and The Discovery Channel are two examples of the successful programming initiatives made possible by the investments of cable operators.

In making these programming investments, cable operators can partake of certain synergies and economies. First, they can utilize the experience and direct consumer contract developed in the day-to-day operation of the cable business to make informed judgments about consumer preferences. While this information does not eliminate the substantial risk faced by any new programming effort, it increases the likelihood of success. Second, cable operators' participation in programming development and ownership also allows them to exercise a constraining influence on the cost of such programming, which, of course, reduces the ultimate price to the consumer.

Senator INOUYE. Thank you very much.

Before I call upon members for questions, may I now call upon Mr. Paxton, a most respected member of the broadcast industry.

Mr. Paxton.

STATEMENT OF FRED PAXTON, PRESIDENT, WPSD-TV, PADUCAH, KY

Mr. PAXTON. Thank you, Mr. Chairman.

As you have indicated earlier, I am president of my own station in Paducah, Kentucky, but I am a past chairman of the NBC Television Affiliates Board, and past chairman of the Association of Maximum Service Telecasters.

I am testifying here today really on my own behalf, and I do so because I care very deeply about the issues which this committee will be studying in the days to come. I thank you for the opportunity to participate.

In fashioning these remarks, I have tried to focus on the issues from the standpoint of the public, rather than the broadcaster, because in the end, that is where you and I must both take our direction.

We have a broadcast system, which is working very well, and has down through the years. It provides seven or more stations to 87 percent of the public. It does this all free of charge and is available to everyone who has access to an electric outlet. And in virtually no case are two of these stations owned by the same company.

But this situation is changing very rapidly. The viewing of local stations, as you know, is diminishing, while the audience of pay services is on the rise.

As a matter of fact, the president of NBC has been saying recently that a couple of years ago we passed a threshold and that the future of broadcasting is a pay service.

I must tell you that has many NBC affiliates deeply concerned.

But the public has not been generally alerted to this thesis. I believe, however, you can expect a firestorm of protest if your constituents wake up some day to find out that virtually the only desirable services they can get are ones that they must pay for.

And I really do not think it is overstating it to say that the future of the broadcast service is hanging in the balance, and that has profound ramifications for both our political and our social systems.

That possibility is surely what led this committee to hold these hearings.

We have been asked to look at both the past and the future of television. For me, the public's television service in the past was characterized by three great strengths which are unique to our American system of broadcasting.

The first of those is the responsiveness of local broadcasters to community issues and needs. The second is the special benefits to the public of the complex and very delicate affiliate-network relationship. And the third one is we have a nationwide service of free, universal and local television.

Because this unique system has been able to stay in such close contact with its audience, it has been able to adapt to new social needs, new technologies, shifting public tastes, and numerous business challenges. It has grown both in diversity and effectiveness. And there is every reason to believe that it can continue to grow and adapt in the future.

But it is not clear that we will be permitted to do that. As we gaze toward the future, it is easy to foresee two quite different scenarios.

In the first vision, say, at the turn of the century, broadcasters would continue to reach 98 percent or more of the American public. Competing local stations will carry high-quality local news and information programs, presenting different viewpoints from a variety of community leaders.

Still available, free, on locally-oriented stations, will be presidential debates, the Super Bowl, the revolution in China, Bill Cosby. Those stations will have invested enormous sums of money in plant to bring about the new high definition television service.

America will be the only country in the world where this advanced technology is locally-based, is not subject to a viewer fee, and is available to all the citizens.

Cable systems will extend the coverage of broadcast stations and provide a rich, additional array of entertainment, sports and niche programming to their subscribers.

The second view is quite different. It presents a parched landscape in which the public is underserved and thirsty for more accessible programming. Over-the-air service will be withering away, far too impoverished to implement high definition television, and with prospects only of further decline and ultimate demise.

Under this scenario, tens of millions who cannot afford to, do not choose to, or simply cannot receive alternative media, will become disenfranchised of news, information, sports, entertainment, and access to their political leaders that free television has provided them.

Instead, the prospect is for virtually all television service to be delivered by wire or fiber through one outlet in each community, a cable system; 30 percent of Americans will be left out because they are not subscribers.

And fewer than one percent of Americans will have a choice of cable systems to which to subscribe. That will not have changed.

The vast majority of cable systems will be owned by half a dozen extremely large companies, perhaps the Bell companies. These companies will be co-owned, or have extremely close financial arrangements, with a handful of national program suppliers, which may include the remnants of the national networks, located in Los Angeles and New York. Programmers outside these conglomerates will face an uphill battle to break into the market.

Viewer access to this programming will be by fee, but the programming will contain heavy advertising content. Indeed, local businesses may have to deal with only one supplier of local video advertising space who may also be the only supplier of yellow pages advertising as well. There will, typically, be a single local news channel in each community which the telephone company or cable system programs itself or subcontracts out. National news will be provided by the huge conglomerates described above. Special interest groups may be able to lease part or all of other cable channels to propagandize their particular viewpoints, but otherwise there will be little diversity.

Now, some may say this is a farfetched scenario for the year 2000, but when here in 1989 two of the three national networks are pouring huge sums into cable programming and seeking the right to own cable systems, and when in 1989 the head of the most successful network, my network, states that he has seen the future and the future is pay, this scenario must not be dismissed as a bad dream but taken seriously as a real threat, not only to our business but to the public as well.

What is the driving force that could lead to this scenario? I believe it is the whole chain of events triggered by the emergence of cable television and its deregulation at both the federal and local level.

Cable is now characterized by a high and growing degree of both horizontal and vertical concentration, and it has led in some cases to competitive abuses. Cable has not been fairly and properly integrated into the rest of the marketplace, which after all is riddled by competitive imbalances caused by government regulation and copyright legislation, both of which were written in a vastly different era.

Two of the ripple effects resulting from cable's emergent power are, first, to impel the broadcast networks, understandably, to seek relaxation of the regulations that limit their ability to vie with and become a part of cable. And, secondly, it has enticed the telephone companies to enter the program distribution business.

These two major trends further threaten our present system without providing adequate substitutes or compensating benefits. In my view, the following steps are necessary to make possible the more positive and desirable of these two scenarios I have mentioned.

First, the networks should be allowed somewhat greater regulatory flexibility so that they may compete more fairly in the new competitive landscape where cable now has enormous power due to its gatekeeper status, its vertical and horizontal integration, and its almost total deregulation. The elements to be considered for a network deregulatory package include the financial interest rule, the syndication restriction, the prime time access rule, and others.

I do not believe that all of them should be eliminated or cut back. The competitive threat of cable does not justify upsetting the creative but precarious balance that underlies the affiliate/network relationship. Perhaps there may even be elements of a network package that should be more restrictive than at present.

Secondly, freeing the networks from some of these regulatory restraints is only part of the solution. The other is to curb or roll back vertical integration and other competitive imbalances in the cable industry. Furthermore, some form of cable must-carry should be adopted. Protection should be afforded against channel shifting by cable systems, particularly when the channel shifting is motivated by improper and anticompetitive economic self-interest. And the compulsory copyright license should be reconsidered.

Third, telephone companies should not be allowed to engage in programming. At most they should be permitted to provide cable facilities on a common carrier basis with a prohibition against their participation in programming. Both history and the FCC's files demonstrate that due to their enormous size and their concomitant indecipherable accounting systems, telephone companies are impossible to regulate in such a way as to produce the intended result. Moreover, when you add the telephone companies' staggering resources to cable's bottleneck powers and its regulatory and copyright advantages, it is easy to see why telco entry into cable would almost assure the gloomy scenario for the future described above.

Fourth, the transition to high definition calls for cable and broadcasters to cooperate. Together we can devise HDTV solutions that will give the American public high technical quality at a reasonable cost and with substantial opportunity for further improvements in the future.

The benefits that local, free and universal television service provides to the public cannot be adequately measured by a dollar index. Indeed, an FCC staff study several years ago found that free television service provides consumer benefits of over seven times its value based on advertising revenues. Our offerings are a mix of public service and commercial enterprise, network and other national programs and local originations. The mix works—better than any other systems in the world. The public votes for this system over and over again, day to day, and hour by hour. Americans rely on it to an extent and in ways that we all take for granted.

In charting the future within the broader communications environment that is emerging, more is required than an acquiescence to so-called marketplace forces. Indeed, the concept of a free marketplace here is a fiction. From the allocation and licensing of spectrum to cable's supremely intrusive compulsory license, this is a marketplace that is defined and fashioned by government policy. The wraps have been taken off cable, but the effects on others, from programmers, to networks, to stations, to the public have been largely ignored. Such changes should not have been made on a piecemeal basis, and now we must cure the problems caused by this mistake. In doing so, we must maintain the public's unrestricted and universal access to a free, locally oriented broadcast service that is attuned to their needs.

Thank you very much.

[The attachments referred to follow:]

APPENDIX A

FACTSHEET ON THE BENEFITS OF LOCAL TELEVISION

-- 98% of American households have one or more TV sets; 63% have two or more sets. (Often second or third sets are not hooked up to cable in cable subscriber homes.)

-- 65% of the American public relies on television as its principal source of news and information.

-- Americans watch local news programs more often than they watch network news programs.

-- The average American household watches television 6 hours and 53 minutes a day.

-- Among cable subscribers 75% of viewing is of over-the-air stations.

-- Americans have an investment of $80 billion in current television sets.

-- The top 20 television group owners own 136, or 12.7%, of 1,070 commercial stations; while the top 20 cable group owners control 70% of all cable subscribers.

-- In 1987 the top 10 television group owners had an aggregate share of total national weekly circulation of 32.9%, down slightly from their 35.0% share ten years ago. The comparable figure for cable was 48.8% (of total subscribers), a quarter more than the 39.0% figure in 1977.

APPENDIX B

FACTSHEET ON CABLE

-- In only 32 out of more than 8,000 cable communities (0.4%) is there more than one cable system operational.

-- Today the top 20 cable group owners control almost 70% of all cable subscribers, while in 1981, 70% were controlled by 50 group owners.

--34.5% of all cable subscribers in 1988 were served by the top five group owners.

-- TCI, the largest cable operator, has an ownership interest in 600, or 7%, of all cable systems, while Gillett Holdings, the largest owner of television stations, owns only 12 of 1,070 commercial stations, or 1%.

-- TCI has more than 8 million subscribers, or 16.4% of all cable subscribers in the country.

-- 20 of 52 basic cable networks, including 12 of the top 20, are owned in part by cable system operators. Seven of the nine pay cable networks are owned in part by cable operators.

APPENDIX C

FACTSHEET ON TELEPHONE COMPANIES

-- Telephone companies had revenues of $90 billion in 1987. The Regional Bell Operating Companies had revenues of $74 billion, compared to a total advertising revenue of $23 billion for the entire television industry.

-- In 1987 local exchange carrier assets were $169.6 billion.

-- 80% of all telephone service is provided by nine companies.

-- The General Accounting Office recently concluded in a study of the FCC's capacity to audit and control telephone companies' ability to cross-subsidize between regulated and competitive ventures that the FCC would be able to examine each of its audit areas for the major telephone carriers only once every 16 years

RESPONSES OF FRED PAXTON, PRESIDENT, WPSD-TV, PADUCAH, KENTUCKY

1. Is the media market an international market? - or is there a distinct U.S. market?

There is a distinct programming market in the United States, although it is becoming more international. Programming in the United States is also localized or regionalized, more so than perhaps in any other country. The structure of our television system, which is based on local stations, reflects America's tastes and traditions. Thus, local news is viewed more than network news, and even on cable systems 75% of the viewing is of over-the-air stations.

Nevertheless, the competitiveness of American media companies in the emerging international market is hampered by restrictions imposed both by the FCC and by foreign countries. Many foreign countries impose an absolute limitation on the number of television programs presented that are produced abroad -- limitations that are directed against and have by far their greatest impact on American programming. This is a trade issue that the American government should focus on. The FCC's restrictions on the networks having an ownership interest in programming or engaging in foreign syndication also hurt our ability to participate in the international programming marketplace. The FCC should closely re-examine these restrictions. I believe they can be revised to allow this country to be even more competitive in the international program market without impairing the public's interest in its existing local television service.

2. Looking at the U.S. market, should the market be defined as all video programming? Or should it be further subdivided into multichannel services and single channel services? What about pay services and advertiser supported services? Are these services separate markets?

At the very least, multichannel services, including cable, DBS and wireless cable services such as MMDS and MDS, and single channel services, such as broadcasting, should be looked at together. All of these services compete with one another for programming, viewers and advertisers. For the same reason, pay services and advertiser supported services must be looked at together. Yet the fact that these services are competitive in very important respects does not alter the fact that broadcasting services have a unique role. They are structured and regulated to serve the public interest, while at the same time they must compete in the same marketplace as these other services.

3. There appears to be a trend of programming migrating from over-the-air television towards cable. Why is this occurring and will it continue? Will local news be the next service to migrate to cable? If not, how will this affect local television stations?

The economics of cable's subscriber and pay-per-view revenues plus its advertising potential give it a tremendous advantage over broadcasters who are limited to advertising's cost-per-thousand economics. Moreover, cable is not shackled with the regulatory restraints placed on broadcasters. Given these circumstances, there is every reason to believe that the present migration of programming to cable will continue and at an even faster pace as cable's penetration increases.

National news resources -- talent, producers, facilities -- could easily become part of this trend. Cable has thus far shown little interest in presenting local news. But if local stations have their economic base eroded by further cable incursions into the rest of their broadcast schedule, local television news might also become vulnerable. It is clear, moreover, that if local news resources migrate to cable, they will not carry with them the public interest responsibilities now shouldered by broadcasters of providing community-responsive service.

It is also clear that local news is an integral part of stations' larger programming packages. If the networks were to move their programming to cable, over time or more abruptly, local stations would lose the bulk of their advertising revenues and probably could not continue to fund local news, at least to the degree they do now. In addition, the resulting market for local news, reduced by the lack of the surrounding network programming and the revenues flowing from this programming, would likely support only one source, thus decreasing the public's access to a diversity of voices. In each case, the losers would be the viewers who would no longer have a quality local news service and the local advertisers who would no longer have a cost-efficient vehicle for advertising their wares.

4. What are the economies/synergies in owning both the source of programming and the distribution outlet?

Allowing cable to own both the source of programming and its distribution essentially gives the gatekeeper a vested interest in who gets through the gate. For local broadcasters, there is grave danger that vitally important cable carriage decisions, including whether a system will carry a station and on what channel, will be made on the basis of the cable system's self-interest and not on the basis of consumer demand. I have heard of numerous instances where cable systems have dropped nearby over-the-air stations that many cable viewers enjoyed in order to carry cable channels in which the cable operator had an ownership or other financial interest. There may be synergies in vertical integration but where the integration is built upon an unregulated monopoly the risk of abuse is simply too great.

5. In broadcasting, when new stations are available, we give the first shot to applicants who do not own other stations to increase the diversity of ownership. Do we need to strengthen this policy? Should we extend this policy to other services?

As a local broadcaster, I do not agree that untried applicants for a new facility should be preferred to other applicants who have broadcast experience and are providing effective service to the public. Accordingly, I believe we should back away from this policy and not extend it to other services. Wholly apart from the general issue posed by this question, it is essential that existing television operators obtain the channels necessary for them to introduce HDTV. No thought should be given to assigning this HDTV resource to new applicants rather than existing licensees.

6. Radio programming is often talked about as the most local medium, but what about the growth of automated programming from national networks?

As a local television broadcaster, I cannot agree that radio is the most local medium. My station devotes a tremendous amount of its resources and energy to providing high quality local news, local public affairs programs and local service to its viewers. In television I believe it is important to strengthen network operations by eliminating the financial interest rule and reviewing and relaxing the network syndication rule. Sensible revision of the network rules should result in a stronger network/affiliate relationship that should, in turn, result in stronger local-station service to the public. This process should enable free, universal and local television service to remain viable in an increasingly competitive environment.

Senator INOUYE. Thank you very much, Mr. Paxton.

You have painted a rather grim scenario for the year 2000, and I quite agree with you that it is not too farfetched. There seems to be a trend of programs migrating to cable.

Is there anything in the wind suggesting that this may happen to broadcast news also?

Mr. PAXTON. Well, it depends upon whether the networks continue in their present state. And one of the dangers of having just one source of programming into a home, if it comes through one wire, is that the local news is likely to wind up then coming from one source. So you will not have the diversity that you now have in a marketplace that typically contains half a dozen or more stations.

Senator INOUYE. What did you mean by regulatory flexibility? Specifically, what sort of flexibility would you provide the broadcast industry to slow down this scenario?

Mr. PAXTON. Well, I think it relates to a lot of the regulations on the networks now. It is the prime time access rule; it is the financial interest rule; it is the syndication restrictions. One hand of the broadcast networks is tied behind their backs, and that is not true of cable.

They have their vertical integration. They have most of the regulations removed. And so the networks are at a severe competitive disadvantage.

I think there is an array there, a mix of regulations that should be reviewed. I do not think they should all be changed. I think they have to be looked at as a package, and the package as a whole needs to make some sense.

Senator INOUYE. Some have expressed the fear that these hearings may turn out to become a cable bashing session. I can assure you, Dr. Malone, that is not the intent of this subcommittee.

But as you pointed out, your major concern is to have satisfied cable subscribers, and I think it is safe to state that Senator Metzenbaum's involvement in this area came about primarily because of subscriber dissatisfaction in certain areas where rates have gone up rather sharply.

I realize that you are number 49 out of 50, but could you once again tell us some of the reasons why you believe rates have gone up in some areas so precipitously?

Mr. MALONE. Well, I think you have to look at the whole picture. First of all, cable was regulated at the local level for many years and in many cases was unable to keep pace with inflation. The unregulated part of our business—the provision of the subscription services Home Box Office, Showtime, Disney—therefore had to carry a disproportionate share of the burden of the whole facility. In other words, we basically charged too much for HBO and not enough for basic cable.

When deregulation came, the pre-emption by the FCC, what most cable operators did, what we did, was to substantially reduce the charges for the subscription pay services and increase the charges for the basic services. We simultaneously added a number of new basic services. I think in our systems we added six to seven channels at the same time that we changed the rates. We also did away with a number of incidental charges; for instance, we used to have an additional monthly charge for extra TV sets in the home.

We gave that charge up. So when you look at what happened to the average bill, as opposed to what happened to the basic charge, you see a much lower percentage increase.

I might also say that the cost of the programming that we deliver, our cost of the programming, has grown over the last five years by over 250 percent. We have detailed that in my written testimony. We think that by and large this was in response to consumer demand.

What we have here is a situation where the overwhelming majority of the subscribers want and want to pay for more diversity and better quality programming. We have some people who would prefer not to. And our service by and large requires that we provide the same service to all subscribers, to be economically viable.

So some of the legitimate difficulties we have is this balancing act—do we provide the majority with what they want and raise the rates, or do we deny to the majority additional programming options in order to keep the rates low so that they are most broadly available. That is one of the dilemmas in the business. But that is essentially what has motivated it: more channels, better quality channels in response to the customers' demands.

I know the New York Yankees situation was referred to, and that represented a terrible dilemma for a cable operator. We, in effect, were told that we had to either increase our rates and provide the Yankees, or we had to give up the Knicks and the Rangers, which was, frankly, a very difficult situation for us. We ended up making the best of a difficult situation by providing the Yankees to all of our subscribers in an arrangement with the supplier that if they further increase the cost, we have the right to make the service optional to our subscribers, which is what we would have preferred from the beginning. So those are the things that really drive the rate structure in the industry.

Senator INOUYE. You have heard Mr. Paxton paint this rather grim picture. Do you agree with that?

Mr. MALONE. I think he overstates the situation. I might point out that a lot of the erosion of the network share has come at the hands of independent television broadcasters like the Fox network and the Tribune. So there has been essentially a shifting around of viewership.

The networks in prime time are still overwhelmingly the dominant deliverers of service, and the economic returns on original invested capital in the broadcasting industry continue to be the highest in American industry. So I think tears are premature.

Clearly, the long-term trends, and I guess just a sense of equity, Senator, would indicate that the local broadcaster who does play, I think, a very important role in the whole communications setup in the country, needs to be guaranteed access to the consumer, in our view, and needs to be monitored in terms of his economic health and ability to perform his services.

This thing is all very philosophical. The whole media business is driven by the fact that it costs a lot of money to create software, be it information or entertainment, but the marginal cost, once you have created it, is very low, and that drives all of these media companies toward trying to be very large. All of the economics drives them toward size. That goes for the broadcast networks. That goes for the cable programmers. That goes for Hollywood.

And I have always felt that government needs to have a regulatory role in all of these issues. There is a balance. Size is good to a point. It increases efficiency and makes it possible to do things. Beyond that point it becomes limiting.

I do not believe any of us in the industry had the vision that we were going to be turned loose in the sense of the local newspaper publisher and could do anything we wanted forever without being accountable to anyone. We feel that we are accountable on rates to the FCC and to our subscribers, and on all other issues to the local regulatory authorities or those states which have asserted jurisdiction. So we are fairly regulated.

I think that when Congress passed the act in 1984, they did rely on the FCC. In fact, they mandated a review of the definition of effective competition in five years, which I think comes up next year. So I do not believe that Congress just sort of threw the reins up in the air and let the horse run off. I think that Congress relied on an active and involved FCC to keep the tension with the various industries which it is chartered to regulate.

Senator INOUYE. Mr. Paxton, do you believe that cable systems should pay for local TV signals?

Mr. PAXTON. I think there needs to be a linkage between their compulsory license to a local signal and the must-carry provision of it. I think if they are required to carry the local station, they should not be charged for having to do that. I think the two go hand in hand.

Senator INOUYE. Dr. Malone.

Mr. MALONE. I agree.

Senator INOUYE. I have many other questions, but I would like now to call upon my colleague, Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Mr. Malone, I paid attention to what you had to say, and I agree with you wholeheartedly when you say that this whole issue is driven by philosophy as to whether people have a right to view various programs and at what cost to the consumer. I am not sure if we ever envisioned an example such as you said where most people who live in the largest metropolitan area in America might be forced to choose, or the conveyor of entertainment might be forced to choose, between the New York Yankees or the Knicks and the Rangers.

If we believe that there is now a multitude of ways of transmitting information and entertainment to the American people, and that this diversification continues to grow, yet we are in a position where a substantial majority of the people who live in the New York metropolitan area do not have access to viewing their baseball team, which from the inception of television was something that all of them had, and for free.

Perhaps you can tell me how all this came about, and then also tell me how you can expect the citizens of that area to be satisfied with the present situation.

Mr. MALONE. Well, there is more history to it, because I think you have to look at how we cable operators got where we are with respect to the distribution of the Yankees. For years the Yankees were broadcast over local television, which they continue to be, by the way, and their home games, which for years baseball owners did not want to televise in the local market for fear of what it would do to their local attendance, were not broadcast at all in the local market.

Some years ago they decided that if they offered a number of those local games on a subscription basis over cable, that it was a way for them to, in fact, make more money, increase the value of their rights, and limit the distribution so that it would not adversely affect attendance. And they built a business on that. In effect, somewhere around 20 percent of the cable subscribers in the metropolitan New York market were paying on an optional basis to see those home games of the Yankees. When that contract came up for renewal, it was bid out by Mr. Steinbrenner. I mean, if anybody should be the bad guy in this scenario, let us make George the bad guy.

He, as a good, enterprising capitalist, found a competition. On the one hand he had the distribution channel that he had always used for Home Games, an optional service. The cable operators essentially pay only for those subscribers who take it, and it is a little distribution business. On the other hand, Madison Square Garden, owned by Paramount, Gulf and Western, had a basic cable service that had been around for years, which essentially delivered on basic cable probably two-thirds of the Knicks and Rangers games. Incidentally, they own the Knicks and Rangers. I mean, they are the owner of Madison Square Garden and the Knicks and Rangers. They had made a business of distributing, through cable, as a basic service, for which we paid a substantial amount of money, the Knicks and Rangers. They wanted to turn their Knicks and Rangers distribution into a year-round service, and what they needed was baseball. So they saw the opportunity to bid against this other distribution methodology for the Yankees. Steinbrenner just played them off against each other. Paramount was anxious to get more heavily into the provision of this kind of programming, and they paid a very, very large price.

The cable industry basically said well, what do we do? Who is going to pay for this? How is it going to be distributed?

I might say in the context, they always wanted to continue to broadcast the away games as they always had. I mean, there was never an intention, as far as I am aware, to deny the continuity of the local broadcast component.

But we were confronted with a situation in which we were told that there was no unbundling. In other words, you had to take the Yankees along with the Knicks and Rangers, and you had to carry them as part of your basic service, for a substantially higher fee, or you could not carry anything.

Senator McCAIN. And you think that that is not a monopolistic practice?

Mr. MALONE. I am not an antitrust attorney. What I am is a cable operator.

Senator McCAIN. Nor am I. But if it walks like a duck and quacks like a duck, which seems to be so popular a phrase around this town.

Mr. **Malone**. Right. But as a cable operator I was trying to make peace, I was trying not to get my subscribers upset. We are the second largest operator in that market.

You have to understand, this is all in the context of the Knicks and Rangers getting into the playoffs. I mean leverage was pretty strong on their side.

Senator **McCain**. That is my point.

Mr. **Malone**. So we basically cut a deal with them where we would add the Yankees, we would eat the cost, but if in the future they had to substantially increase the cost, we would have the option, then, of offering the whole package as an optional service and reducing our basic rates. That is the deal we ended up cutting. It was making the best of a difficult situation.

In their defense, their view of it was if the Yankees were on cable, it would maximize the distribution, maximize the advertising potential that would subsidize the distribution, and drive the per customer charge to the lowest level that it could be. So they were looking for the scale economics of massive distribution, and they believed that over time they could get the cost to the cable operator, and therefore to the end subscriber, to a level that would be acceptable to the marketplace. And that is why they went that way.

You know, in many of these situations the cable industry is almost in the role of an operator of a newstand; where one of our publishers raises his prices, our sales just go down. I mean, we cannot control those things.

Senator **McCain**. If that publisher owned all the newspapers, yes, because people would have an option of buying another newspaper. In this case they do not have the option of watching another athletic team.

Mr. **Malone**. Here is the real dilemma. That is exactly it. When you get into these niche businesses, as we call them, they develop very strong followings, very strong franchises, and the owner of those services has unusual economic leverage. In fact, those services become quite profitable over time.

Senator **McCain**. As does the owner of a very popular magazine or newspaper, unless that newspaper or magazine owner decides to raise the price where then the subscriber chooses another newspaper or magazine which is less expensive.

Mr. **Malone**. That is right.

Senator **McCain**. And that option was not available at this point as far as your business is concerned.

Mr. **Malone**. Correct. In our view, a service that starts to cost a disproportionate amount of the programming budget and has support from fewer than half of the subscribers should be purely optional to the consumer. And we would much prefer that mechanism, and that way it is a self-governing process. Where we are compelled to carry an expensive service on basic because of economic leverage, we do not like it at all. I mean, it is very uncomfortable for us to be put into that position, and in effect, we become a tax collector, as it were, for that particular program owner. That is one of the internal difficulties in the business.

Senator **McCain**. I guess it is getting repetitious, but it is due to a monopolistic situation, in my view. You and, most importantly, the ratepayers were placed, I think, in an unacceptable situation, which would not have been the case if there had been not the vertical monopoly as well.

Mr. MALONE. In sports it really starts with the team owner and his control of the sports rights. His ability to make exclusive distribution arrangements in effect guarantees that there is going to be this kind of economic leverage somewhere in the distribution channel.

Senator MCCAIN. Well, I am not personally a fan of Mr. Steinbrenner's either, but I hesitate to put all the blame on him for this situation.

I am taking too much time, Mr. Chairman.

Mr. PAXTON. Senator, might I comment just briefly on that?

Senator MCCAIN. Sure.

Mr. PAXTON. I think the various businessmen involved in this transaction were doing what they should have been doing for the benefit of their stockholders, and they were doing what you would reasonably expect them to do.

Senator MCCAIN. But did they do what was——

Mr. PAXTON. It is a classic example of what happens when you get too much vertical integration. The bizarre results, which are unforeseen at the outset, occur, and the public suffers.

Mr. MALONE. But there is no vertical integration. I mean, Paramount at the time of this owned no cable, no broadcast in the market. They strictly owned the teams and offered distribution with the rights. So I do not think you can attribute this to vertical integration.

Mr. PAXTON. Well, horizontal then, because they owned two teams and the rights to a third.

Mr. MALONE. But not horizontal control of media; horizontal control of sports rights.

Senator MCCAIN. No, but if you control the three teams, then you control, obviously, the media because there are no other options. But I just think this is an example of the bizarre situation that we can find ourselves in from time to time.

I just have one more question, Mr. Chairman. I have lots of other questions, but I know other members have questions.

Mr. Paxton, you mentioned in your testimony that the president of NBC has been saying that he sees broadcasting as a pay service in the future. This goes back to this philosophy, which I think, by the way, is a dramatic change from the over-the-air philosophy that we have had that all Americans had to do was buy a television set and then they could see whatever they want. Our rural residents of this country have already experienced that, because the major networks have already begun to scramble, as you know, which has required them to then acquire a decoder and some service, which by the way continues to interest me, that you cannot buy one, you can only lease one, reminiscent of the days of IBM when computers were only for lease and not for sale, or a continuous fee has to be paid, Mr. Malone, is what I am saying. There is no amount of money that I can pay and say give me this, and it will pay for my services forever. I think there is something inherently wrong there as well.

But, Mr. Paxton, does it concern you that the president or the head of a major network would now espouse a philosophy that television, network television should be a pay for services situation?

Mr. PAXTON. I am not sure that he has quite espoused that, but it does concern me a great deal that there is this potential, that he sees the future of broadcasting as being more and more a pay service. And I think obviously it would be a terrible thing for me. I think it would be a bad thing for the public if the networks moved to a pay service, because large numbers of the public, as you have suggested, would not have access to that, either due to economics or location.

Senator MCCAIN. Did you want to comment?

Mr. MALONE. I would like to comment in Mr. Wright's defense that, with particular reference to the way in which NBC has dealt with the summer Olympics. They bought all of the rights for the summer Olympics three years in advance. They have basically, I think, committed that all of the normal broadcast coverage of the Olympics will occur on over the air network television. However, they have also said that there will be a supplemental feed of as many as three or four channels which will be in depth and continuous coverage of everything at the Olympics, something that the American public has never been exposed to, which will be made available over cable as an optional service. The provision of that cable service allowed them, in effect, to make an economically viable deal on the summer Olympics.

So I think what Mr. Wright is really saying is that he needs a cable distribution element in his total programming equation in order to be competitive into the next century.

Senator MCCAIN. Well, I will be very interested in seeing what happens to the Olympics after that, because I view it as the first step in the transition between providing over the air television coverage of the Olympics to what we have seen with the New York Yankees—a pay service. I would heartily disagree with the American people having to pay to watch the Olympic games.

I have no more questions, Mr. Chairman.

Senator INOUYE. Senator Gorton.

Senator GORTON. Mr. Malone, I agree with your description of this New York situation which you describe as not involving vertical integration. I do not think it even involves horizontal integration when you are speaking about three different sports. But, of course, Mr. Steinbrenner is a part of a legally sanctioned monopoly in organized baseball.

Would you regard it as socially desirable that even though we left it to the discretion of individual owners to decide whether or not they wanted to televise their product at all, if they did decide to televise their product that it would have to be based on a nonexclusive license equally available to every provider?

Mr. MALONE. Of course, we do not run the industry; we run a company. We have said on various occasions when it has come to our attention that sports rights are likely to be bid for that our currently broadcast games—for instance, the baseball playoff games, which were recently renegotiated as part of the network national baseball league rights—that we would not pay, nor would we collect, a surcharge if someone were to take those rights and move them to cable.

It is in our own enlightened self-interest. We do not need to siphon, nor should we siphon, currently affordable broadcast programming over to cable. I mean, our business is doing very well. We do not need it. This movement is not a cable industry, cable distributor, cable operator driven force. This is a competitive force of programmers and program packagers who see an opportunity to gain control over certain rights, and then in the best American entrepreneurial traditions, auction them off to the high bidder and make as much money as they can. And they will continue to do that with the pressures for higher and higher rights fees unless there is some regulation or legislation that limits their ability to do so.

So, you know, I am powerless to stop it from going in that direction as a cable operator other than to merely say that I will refuse to pay for it. But if they buy the rights, and then the only way my subscribers can see it is if I charge them for it, I am going to be under enormous public pressure to go ahead and pay the fee, pay the quarter, pay the 50 cents, pay the dollar, to distribute the program.

It does not really do anything for the cable industry. I mean, our subscribers are seeing those events now over our retransmission of the broadcasts. We are perfectly happy with that situation. So there is nothing in it for the cable industry, and if that was an appropriate area for government involvement, I probably, as a sports fan, would cheer.

Senator Gorton. Well, that was a very good answer, maybe I was about to say, but it was not an answer to the question I asked. Perhaps it was in the last few words.

Let me ask you one that comes somewhat closer to home. You have described eloquently, and with a degree of pain, the change in the situation with which you are faced, when you do wish to provide a service, which obviously many of your customers want to have, and are then constricted in the way in which you can make that offering. But basically, your customer can only choose to get that programming through you, or at least much of that programming. That customer can get whatever is on the air on a station like Mr. Paxton's, which, as you have said, is becoming less and less at this point; but a wide range of those televised services he can only get from you.

Should we attempt to pass legislation here which attempted to assure or at least to encourage the provision of competition to you for the provision of the kind of programming which you transmit essentially on a monopoly basis to the homes within your franchise areas?

Mr. Malone. Well, I really feel, first of all, that to try and create or develop competition when the economics will not support it is a mistake. I mean, it would be the equivalent of government deciding that there should be a second newspaper in a particular community because they only have one, and trying to come up with various tax incentives, various other incentives to create competition where the market, the economics simply do not support it.

I think that government should look at cable and decide if cable does represent a bottleneck, if it does abuse its ability to select amongst various optional services. That is the area that should be dealt with. That area should be regulated. That area should be legislated if necessary.

Senator GORTON. But you do not say that in the case of a one newspaper town with respect to newspapers.

Mr. MALONE. You have a very real conflict there because of the First Amendment. I am sure that there are many people that would love to have two newspapers in their town. Certainly a lot of Congressmen who have felt the lash of the local publisher would welcome competition.

Senator GORTON. Two just makes it twice as bad.

Mr. MALONE. But, you know, for our society I do not think we want to artificially create excess capital investment if it is not necessary to solve a problem. You know, we do not want to burn down the barn to get roast pork I guess is what we would say out west. It is really more an issue, I think, of close regulatory supervision to see if abuses are developing and then deal with those specific abuses. If there is no discipline in terms of the rates, then regulate the rates. If there is no discipline with respect to free access where the decisions on what channels a cable company carries are not made because of the consumer demand or on an economically sound basis but are done because of some other vertical interest, those areas ought to be dealt with specifically.

I do not think government can escape in the media industry a close regulatory relationship with the media, because I think, as I said before, philosophically the scale economics in the business are so strong that there will always be, more than any other industry, there will always be a desire for scale economics, for size. And I think it is healthy, up to a degree.

Senator GORTON. But Mr. Malone, now, of course, the government is keeping at least one major group out of the market by law which could provide these services, the telephone companies. Is not your theory one in which we should allow that competition to take place?

Mr. MALONE. The difficulty there, of course, is that they are a regulated industry. They essentially have a government monopoly, no question about it; it is a utility. Everybody buys their telephone from the local telephone company. If I was convinced that there was no exposure to cross-subsidy, I would say sure, everybody should come in.

We publicly are in favor of the Bell operating companies—we, our company—being allowed in outside of their service areas. All other phone companies can operate outside of their service areas. It really is an issue of cross-subsidy and whether or not the telephone ratepayer will in effect end up subsidizing an intrusion into a competitive marketplace.

Having started my career with the Bell system, at Bell Labs and AT&T, having worked on their side in some regulatory issues, I know how difficult it is to regulate the Bell system. I mean, even if they wanted to be good boys, they cannot, seriously. Their accounting systems, all of their motivations would go toward cross-subsidization.

When I entered the industry, I entered as a major manufacturer, constructor, and financer of cable properties. My biggest customer was the Bell system. We sold all the equipment through Western Electric. While small operators were negotiating and getting 30 and 40 percent discounts from our list prices, Western Electric was buying our equipment at list. They did not want to get the capital down; they wanted to get the capital up. I got that message very clear.

So unless you totally change the way in which telephone services is regulated and get away from a theory of rate-based capital investment regulation, you have this enormous exposure to cross-subsidy; and, you know, I think that is really the danger. And I think, quite rightly, if you were to drop the fence, you would see a merger of the Bell operating companies and the cable industry. That is what would have been accomplished. And then you would probably find yourself regulating cable through telephone, or vice versa. That is my personal perception of what would happen.

Senator GORTON. I have gone well beyond my time, Mr. Chairman. Back to you.

Senator INOUYE. Senator Burns.

Senator BURNS. It appears to me that one thing has been sort of left out of the scenario here. I have a real problem spending a quarter for a newspaper, because 60 percent of it is advertising. Advertising drives the media business, or it has to this point. It has never been the subscriber. In other words, you have sold advertising, so that that provided the funds to facilitate everything else. And to pay to read somebody's advertising——

I would like to ask both of you about why, if I pay for your cable system, I have to be subject to your advertising, knowing that you are receiving income on both ends of the spectrum?

Mr. Malone first.

Mr. MALONE. Well, of course, some of our channels are advertising-supported, some of them are not. I mean, for instance, C-Span, which we fund, does not have advertising on it.

Senator BURNS. I know there are some.

Mr. MALONE. American Movie Classics does not. The separate subscription services do not. A channel called Bravo, which is a cultural channel, does not. Other services do. It is part of the economic equation of paying for cable.

I think you really have to look and say how profitable is the cable industry on an operating basis. In other words, if somebody has got to pay the bill, is it because guys are paying huge dividends, or taking out huge profits, or whatever. We have never paid a dividend in our company. Our level of profitability is the lowest of any media business. Our rates are low. Our salary structures are low. Our salary structures in our company are embarrassingly low compared to other media companies. So, in effect, we are not hugely profitable.

All of the glamor, as it were, of value in a cable industry is all in buying and selling cable systems because of what people think they might be worth somewhere down the road. But on an operating basis, the cable industry has the lowest return on invested capital of virtually any business. And I might point out that most of the major industrial corporations who have gotten into the cable business over the years—Westinghouse, General Electric—have found the return on invested capital unsuitable and have gotten back out. So, you know, that is my way of looking at it.

The advertiser does help pay the bills for the broadcaster and for the cable company, but the cable subscriber can make his selection among various viewing options, some of which are advertiser subsidized and some of which are not.

Senator BURNS. Mr. Paxton, do you want to address that?

Mr. PAXTON. I see no problem with the correlation between advertiser revenue and subscriber revenue. I think it is part of the mix that helps hold down the cost of both sides of that equation.

My concern would be when the public's access to the whole product may be limited if the only way they can get it is by paying for it.

Senator BURNS. You see, I happen to believe there is a great value to advertising because I think that is what kind of moves the American economy. In other words, they educate and it provides market.

Of course, I happen to believe we operate an economy that until somebody sells something, nothing happens in this country.

And so, I guess when I pay a quarter for my local newspaper to read their advertising that sort of hits at my old Scottish heart a bit.

And the same because when we speak of free broadcasting, basically it is not free. Somebody is paying the bill.

And whether it be the advertiser based upon how many viewers or his cost per thousand or whatever—and, by the way, the advertising dollar provided a very good living for Conrad Burns until embarked upon this adventure. Let that be known for the record, too. In fact, if it was not for the broadcast business, I probably would not be here.

And I was interested in your auction, but I have some serious reservations about in a business such as sports who enjoys antitrust elimination, is not subject to antitrust laws, going out and hammering either the broadcast industry as a free broadcast or a pay service to carry their product and reap the profits on both sides.

In other words, if it is going to be competitive for free broadcast, and we all operate out of the same rule book. Maybe we should take a look at those sports entities that operate in that respect.

I just have some real problems and as businessmen, when there is a product on the market so hot that you have just got to own it almost to make a living, but in this way we are talking about a living and entertainment.

When there is only one entity that is in control and has the ability to turn that spigot—let us face it, businesses' demand drives the price.

That sort of concerns me when one person can turn the spigot and turn off all the televisions sets in the United States.

And I would like for Mr. Paxton to respond to that.

Mr. PAXTON. Senator, one of our concerns with the wired nation concept is the telephone companies going into every home, you then have only that one source and not only do they control the programming that goes in, but then you have got basically only one person selling the advertising.

And so the people who want to advertise then are faced with coercive elements.

Whereas in the broadcast marketplace now, they have got a half a dozen to a dozen television stations they can choose to advertise on.

Senator **Burns**. Or menus on that station.

Mr. **Paxton**. That is correct.

Senator **Burns**. Mr. Malone, do you have any comment on that?

Mr. **Malone**. No, I think that is right. None of us want to see that kind of control over things that we really want.

As I think I said earlier, we view ourselves as sort of a purchasing agent for our subscribers and a good purchasing agent tries to keep a lot of independent vendors going, even sometimes at the cost of subsidizing them rather than allowing a monopoly situation of supply.

And we find ourselves frequently in that position in the cable business.

Senator **Burns**. Well, the state flower is quickly becoming the dish out in Montana, which you'd see if you flew over that country.

I have some concerns about access of our rural people to information and entertainment that the rest of our society enjoys.

I think they deserve that and should have access to it, and I will be looking at that. Mr. Chairman, thank you very much. I have taken more than my time.

Senator **Inouye**. Not at all, Senator.

Senator Kerry.

Senator **Kerry**. Thank you very much, Mr. Chairman. Let me just say at the outset that I applaud your holding of these hearings.

I view this hearing as the beginning of a very possibly long and certainly difficult process of trying to walk through something of a mine field.

I think you are to be congratulated for being willing to try to tackle it, and I think this committee has its work cut out for it.

Ever since 1934 and the onset of the FCC, there has been a long struggle, Mr. Chairman, as you well know, in the effort to try to, number one, guarantee a diversity in the provision of the values of the First Amendment and the government's input to try to do that, and secondly, to try to balance a diversity of economic interests, of class deficiencies with competitiveness in order to be able to let the marketplace with the context of the First Amendment tensions do what it can do.

And we have gone through a lot of variations since we have gone down this road with cross ownership rules, the syndication rules, the 7-7-7 and the expansion to 12-12-12 and variations on that, waivers and so forth.

And now we are at a point where the technology—I think in the 1970s we began to move away from regulation and come back to a competitive marketplace concept where the marketplace was going to deal with a lot of this and deregulate.

And in that process visionaries like you, Mr. Malone, appropriately in the best traditions of the marketplace saw an opportunity and took it.

As old Plunkett of Tammany Hall said, and you did right well at it, too.

But now something else is happening, I think, and it is going to make it very difficult for us to try to sort this out, and that is obviously some of the international aspects of what is going on, of front page news analysis on the battle over Time, Inc.

The "New York Times" last week in the headline said "Battle for Time, Inc.: Bottom Line is Cash."

And the article ended with the following conclusion: "As the battle for Time intensifies, the overall lessons are clear. It is money, not views of the national good that is likely to determine the outcome."

Now, we are compelled to try to turn that around and see that the national good is somehow served in whatever structure we decide to try to deal with this question of an industry that has essentially been unregulated competing with an industry that is regulated with a host of variations in the in between as different entities, whether they are movie studios or cable operators or networks or whatever, grown up to get a small piece of one or the other.

And you have got Pandora's box half open with some parts competing and other parts not.

And we are going to have to try and pick our way through that.

And I think it is an absolutely vital issue because as Senator Burns and others have touched on, it does go to the roots of what has guided government policy about communications in this country.

What kind of social and political ideas will be carried over, what means and how much access will people have, and we have to protect that.

At the same time there looms an imposing problem which is even confounding.

If you look at what Time and Warner were trying to do versus what Gulf Western now may be trying to do, they are two very different things, and I think it is even something we have to touch on, and I am going to ask a question about that ultimately.

But you have to look at the whole larger competitiveness issue and what is happening in other countries.

More than $100 billion has been spent to acquire U.S. businesses of late. Sony Corporation bought CBS Records in 1987. Bertlesman bought Doubleday, RCA. Hachette has Crolier and D'Amanda Communications, Maxwell Communications of Great Britain has Macmillan, Dun & Bradstreet, News Corp., Murdock Company, Twentieth Century Fox, Ziff-Davis, Metromedia, Harper and Rowe, WXNE, Triangle Publications, S. Pearson & Company, Great Britain, Addison Wesley Educational Books, Rank Organization of Great Britain, Universal Studios, and I can go on.

And there is a question, obviously, of what happens in this new marketplace that we are in and what form our communications entities are going to take that at the same time protect our interests in this country in terms of our First Amendment values and so forth but at the same time compete in a wholly different marketplace.

And I do not have the answer to that as I sit here.

But I am going to try to use these hearings as a means of exploring that and seeing where this committee perhaps ought to go.

And my first question to you in that context, Mr. Malone, is you talked about price being pushed up by the New York Yankees episode.

Well, the New York Yankees episode is Marty Davis. That is Gulf and Western.

Now, they have already pushed up the price of Time stock to a point where it is selling, I believe, above what the original offer was, and this is a leveraged deal of a significant sum of money.

And I understand some of those interests that I have just talked about.

Bertlesman, Murdock and so forth are waiting in the wings because in order to support that kind of leveraged purchase, the probability is there is going to be a cannibalization of much of what existed in terms of this publishing/communications empire.

Now, if that is true, that is going to push costs up, and we ought to be looking at that, it seems to me, as part of this context of what protects the consumer and who is going to control it.

Now, I do not know the answer, and I am going to ask some of the economic folks whether a mere title and ownership in a country that still controls by virtue of the FCC and the Congress and the rules is, in fact, something to worry about or not, but I would like both of you to comment in this larger context because I think this hearing is meant to sort of look at the larger issues that are here and then we are going to get micro as we go along.

Would you, Mr. Malone, react to these concerns that I have expressed and give me your sense of what our role ought to be here and of how you envision this thing sorting itself out in keeping with those principles that have guided our actions since 1934?

Mr. MALONE. I think there are lots of reasons to be concerned from the perspective of a purchasing agent for our subscribers. Anything that greatly indebts suppliers to us clearly is going to put pressures on either price or quality, either one of which cannot be good. So that this business of second generation leverage and the financial marketplace recapitalizing these companies, you know, we certainly are not looking forward to that prospect.

We would ourselves do virtually anything that we could do to keep Time, Inc. independent. We do not know what we can do, but we feel that the more independent we keep our suppliers, the more suppliers we have and the more independent they are, the better the product and the lower the cost. So, it is a great concern to us.

I think at the moment the big concern goes beyond Paramount. I mean, Paramount merely put Time in play and the question is will, in fact, a financial buyer come and swallow the whole thing and break it up into its constituent parts and auction it off to whoever in the world can find the most value in exploiting those particular assets.

Of course, with the Japanese companies able to borrow funds domestically in Japan at 3½, 4 percent, their capital costs are so much lower than domestic American firms that if they want it, they can afford it and they can afford to outpay anybody for it. It could be a strategic asset that either the Europeans or the Japanese want to go after. So, those are real concerns and clearly they have been aggressively pursuing these intangible software businesses which incidentally are, I guess, our number two export business.

So, I would think as a nation we should be concerned about what happens to these businesses. As a cable operator. I am concerned about what this programming is going to cost me in the future, how many options I am going to have, and what its quality is going to be, and these are not favorable things that are developing.

While I am on the subject I will say one good thing. I really want to thank Congress for the antitrust exemption on R&D activities that has, I think, the best promise of anything I have seen in terms of the technological base of this country, giving us an ability to get together and compete internationally. That is just an aside, but I think it is a well done on that particular issue.

Senator KERRY. I have a follow-up on that. Let me ask you, Mr. Paxton, do you want to comment?

Mr. PAXTON. I think the American businessman is a genius, and he can take whatever rules you give him and bring about amazing results for his own self-interest. But, as we have discussed here this morning, those results are bizarre as they impact on the public.

I think one of the things that distinguishes broadcasting is we are required to serve the public. We have got to stay in close touch with them, and we have got to serve them.

And I think when you make a cashbox out of any of these media enterprises, you are inviting antisocial results. And as Mr. Malone has said several times this morning, certain economies of scale benefit all the players, but when you get beyond a certain point, then they become detrimental. And I think that is the core issue.

Senator KERRY. Is it realistic, though, or is it not necessary for us—let me ask the first question. Is it realistic for cable to think about entry into the European marketplace?

Mr. MALONE. Well, we operate cable properties in Norway, Sweden, the U.K., and we are building a system in Israel, so we are active.

I might say that the rules in most of the countries in which we operate are slanted very much against U.S. content, U.S. ownership and so you have to be pretty gamey to put very much capital into those marketplaces because not only are the rules slanted against you, but they continuously change the rules, so you never really know what the future holds.

One would not be prudent to put very much of one's capital as an American company into these marketplaces.

Senator KERRY. I do have some follow-up on that, but I will submit those in writing regarding some other aspects of that purchase.

But, as you know very, very well, there are rules. The rules governing the 12 station ownership and 25 percent national market share have governed the broadcasting industry.

You are now almost at, I think, about a 25 percent share or something in that vicinity. Is there anything that makes cable different from the terrestrial broadcast T.V. that should not subject it to restraint at this point in terms of that share?

Mr. MALONE. I really do not know. I mean I think you have to look at behavior and look at abuse and whether in general we have gotten to the point where our scale economics is still beneficial or whether it represents the potential for abuse.

To a large degree the cable industry when I entered it was too fragmented. It was almost impossible to get anything done because you had no one or no group of people who could make a financial commitment.

In that regard I might say that when a program supplier comes to the industry, they do not come to us and ask us if we will carry their channel. They ask us if we will carry their channel and pay them very large sums of money.

When Ted Turner wanted to launch the TNT network, he was asking our company for, in effect, a commitment in excess of a couple hundred million dollars every three years that we would pay to him as a subsidy to get the service going. So, I do not think it is entirely fair to say that we are a gatekeeper.

We are really being asked not to just carry a network. We are being asked, in fact, to underwrite things and in that regard I think we have a fiduciary duty to our shareholders and to our subscribers to try and support those things which look like they will work and will be wanted. And those are all interesting balance questions.

This is, I think, an entire area where a dialogue between the federal regulators and an industry such as cable is a very important ingredient in the whole equation.

Senator **Kerry**. Well, you raise this question of actions and abuse. I read recently that cable operators are now asking programmers to pay for access to favorite slots.

In other words, most of the local communities, 4, 5, 7, 9 are your broadcast stations, so 3, 6, 7, etcetera, are open and since those are right in tangent with the broadcast, those are favored slots.

And rather than the operators paying programmers to put their programs on, programmers would be in a position where to get the favored slots, they are paying the operators and you have got this sort of double whammy in terms of the effect on the license.

Mr. **Malone**. For instance, take ESPN. Normally we cannot disclose our programming agreements, but some of the programmers actually publish their rate charges, and we can confirm that we pay rate charges.

When an ESPN, for instance, offers that—in other words, when they say that it would be very valuable if we were on Channel 7 instead of Channel 17, what they typically offer the cable operator for that commitment is a reduction from a 25 cent a month charge to a 24 cent a month charge. The economics of positioning is in no way so strong as to push the economic equation the other way, and we have no such agreements.

The cable operators pay huge amounts of money to the basic cable programmers for the programming. I know of no instance other than advertising sales where the money flows the other way.

Mr. **Paxton**. Senator Kerry, on your previous point, talking about the networks being limited to 25 percent coverage, that is a regulation that does not apply to our competitors. If you would consider a 25 percent cap for a cable operator, you would have to keep in mind that he would be the only cable operator in that full 25 percent coverage of the country.

Whereas the group broadcaster, who owns stations received by 25 percent of the public, will have half a dozen to a dozen competitors in his marketplace, so there are not equal considerations there.

Senator **Kerry**. Mr. Chairman, I have used my time. I have a lot more questions, but I know there are other senators so I will stop here.

Senator **Inouye**. Thank you. Senator Pressler.

Senator **Pressler**. Thank you very much, Mr. Chairman. Many of the questions I have have been covered to some extent, but I do want to say first of all that I appreciate Senator Metzenbaum's testimony this morning and I agree with it.

Our concerns are somewhat the same. I introduced legislation in this Congress—I think I was the first to introduce legislation in this particular Congress to address this problem and Senator Metzenbaum has introduced two pieces of legislation, one of which is very similar to mine and of which I am happy to be an original cosponsor.

A number of other bills have been introduced recently and I hope that this Committee will report some cable legislation to the Senate before long. I know that this hearing is an oversight hearing. I will save more extensive comments on the cable programming legislation for next week's hearing, when we will investigate the cable industry in more detail.

I did want to say from a rural point of view, however, that this is a consumer issue. Less populated areas of the country, such as South Dakota, are particularly vulnerable to the effects of concentration of ownership. We rely more heavily on alternative sources of programming. Many parts of my state cannot even get the three large networks over the air.

New technologies can bring these rural areas into the information age, but the programming must be available to these technologies and therein lies the problem. If the programming is not available to all these technologies, it doesn't do much good.

Satellite delivery and wireless cable must have competitive access to programming because traditional cable will never reach most areas of South Dakota and similar states, whether it is areas of upstate New York.

Or indeed, I have doubts that we're going to get cable in our home on 4th Street, Southeast, in Washington D.C. for at least another year, and we cannot put up a dish because the Historical Society objects and we cannot get microwave because the Library of Congress blocks the thing. So I live in a culturally deprived area three blocks from the Capitol.

In any event, the concentration of ownership in the cable industry and vertical integration with programmers is a huge impediment in this area.

Let me ask this question. It is a two-part question. As has been mentioned here, recent industry trade reports indicate that TCI and several other multiple system operators may be close to launching a superstation and pay-per-view direct broadcasting service over at KU-band satellite. Does TCI plan to launch, or participate in a launch of such a KU-band satellite service?

Now, the home satellite viewer has been subjected in recent years to more and more restrictions on his access to programming.

Service after service has been scrambled. Now TCI and others plan to move their service to KU-band satellite from C-band.

Most home dish owners have C-band dishes. Will they be able to subscribe to the KU-band service and all of the questions that are implied in this nest of questions that I have asked?

Your response?

Mr. **Malone**. Well, we and several other cable operators have been considering for a long time whether or not we should provide a K-band supplement to our cable service.

There would be under no circumstances an intention of moving the C-band programming to K-band. This would essentially be a facility that, if necessary, could provide broader band distribution if required by high definition television.

It could also provide some of the distant independent signals which probably cable systems will elect no longer to distribute once Syndex goes into place.

I might say on the C-band package, we are a C-band packager, one of 27. I think almost all of the cable programming, if not all the cable programming, is now available on C-band at prices which are substantially lower than the prices available over cable.

Senator **Pressler**. Mr. Paxton, you mentioned vertical integration several times this morning as a major cause of the problems with accessibility to programming.

Do you think we should simply prohibit all vertical integration between cable system owners and programmers, or are we better off pursuing the approach Senator Metzenbaum, I and others have taken in our legislation, namely subjecting the cable programming industry to antitrust laws?

Mr. **Paxton**. I do not see a problem with vertical integration of programming. I do not see a problem with the networks having some ownership of programming on cable.

I do see a problem with the cross ownership of the programming sources and the subscribers, because you have got a direct link there that at some point does provide anticompetitive market forces.

I do not think the antitrust law is sufficient to deal with this. It is too uncertain. In the present atmosphere there is not that much aggressive activity in the antitrust field. It takes far too long and I think the abuses would be so entrenched that at the conclusion of, say, a five-year antitrust suit the horse is out of the barn.

Senator **Pressler**. Mr. Malone, any comments on that?

Mr. **Malone**. I think it is a double-edged sword. The ability of the cable operators to invest and subsidize programming services has really spawned the diversity of channels that we have.

If it were not for that we would have lowest common denominator programming on all of our channels, because most of the niche programming is not economically viable in and of itself and requires a subsidy. Networks such as C-Span, things such as black entertainment television or the Discovery channel—are services which frankly commercial enterprises have never shown an interest in developing.

Yet our subscribers show a very strong interest in receiving services of that kind, so I think it is an inherent part of our business to be able to invest in and subsidize and create those kinds of diverse services.

Senator **Pressler**. Now, Mr. Malone, you suggested greater dialogue between the FCC and cable. Can I take that to mean that you favor greater FCC oversight, even regulation of cable?

Mr. **Malone**. I think that the FCC has substantial authority now to be involved in a number of these issues, certainly in terms of communications policy on vertical and horizontal integration, in terms of the definition of effective competition. There is already substantial authority.

You know, we all know, the government has gone through a pendulum swing very much toward nonregulation even by regulatory bodies, and I think that pendulum logically will swing back into a more balanced situation.

Senator **Pressler**. Getting back to the KU-band satellite service, do you think—will this KU-band service be owned and controlled by cable interests and will this venture include noncable affiliated third parties in the ownership or distribution of this service?

Mr. **Malone**. The terms of this are not settled. There are just discussions going on at this point between various members of the cable industry and RCA, which owns the satellite.

Senator **Pressler**. Mr. Paxton, do you have any thoughts on that?

Mr. **Paxton**. No, I really do not.

Senator **Pressler**. Is it true that the cable MSOs may lock up the satellite with this service—with the KU service—and there are not likely to be any other direct broadcast services available until the next launch of KU-band satellites, which will be four to six years from now? Is that a possibility?

Mr. **Malone**. Well, I think that of course there are other K-band satellites available and there have been various direct broadcast satellite efforts. Several years ago there was one involving GT&E and Prudential Insurance, but I forget the name of it. It was just not economically viable.

There will be other K-band satellites launched I believe in four to six years. I think there are other satellites being launched within the next year and a half, so this is not an effort to deny anybody anything.

We are looking at what should happen if high definition television were to take on a form in which our cable systems could not handle it and we had a sprinkling of subscribers who wanted it. How do we provide that service to our subscribers?

This is motivated by that, combined with what happens when we impose Syndex on January 1st of next year and are in effect required to drop a number of distant broadcast signals that we deliver over cable? This would be a relief valve, as it were, to provide those distant signals to those few ardent subscribers who otherwise would be deprived of access to that programming.

Senator **Pressler**. Broadcasters cannot own cable properties due to their control of the programming message unless they get some kind of an exemption in some cases. Likewise, telephone companies today cannot own cable properties due to their potential for control of distribution.

What is the logic, or why should a large and powerful cable MSO that controls such a large share of the cable market and the programming source be allowed to control the next evolution of technology for direct satellite delivery to the home?

Mr. **Malone**. It may well be the natural evolution of our business and to deny us the ability to evolve with technology I think would be a big mistake.

Senator **Pressler**. You do not think there are analogies between the broadcasters and the telephone company restrictions?

Mr. **Malone**. Well, I might say that seven or eight of the basic cable networks now are owned by the broadcast networks, who also are the largest owners of television stations. There is an enormous amount of common ownership between cable systems, broadcast group station operators and programmers.

Vertical integration is going on all around us. Production companies are buying television networks; they are buying television stations; they are buying theater chains. Broadcast networks are introducing new cable programming networks. This is a much, much broader issue than the cable operator who is also subject to all of these vicissitudes of the marketplace.

Senator **Pressler**. Well, you might say that TCI is not big enough to exert the kind of power that it is being accused of. But speaking of cross ownership or ownership of other things, I understand that the systems TCI owns serve only 13 percent of the cable subscribers, but if you include systems in which you have a minority interest, I believe that figure rises to 23 percent.

That may or may not be true, and you might respond. Is it true that TCI is the largest stockholder in Blockbuster Video, the largest video store chain in the country? I understand that TCI controls over 50 percent of the largest theater chain in the country, United Artists; that TCI has an interest in 60 percent of the package sales to the home dish market. Are those numbers all roughly correct?

Mr. **Malone**. We are not the largest shareholder in Blockbuster, and actually we only own Blockbuster stock because we acquired a cable company that happened to own it. That was not a strategic decision that we made.

As far as the theater chain, ditto. We did not acquire, or go into the theater business. We acquired a cable distribution company that happened to be in the theater business.

Neither of those are strategic assets to us. They are all purely financial assets, yet we cannot efficiently sell them because of high tax liabilities that would be incurred in doing so.

With respect to—what was the third?

Senator **Pressler**. Sixty percent of the package sales to the home dish market.

Mr. **Malone**. No, we certainly do not.

Senator **Pressler**. But you have have an interest in 60 percent?

Mr. **Malone**. We have 46,000 customers that we deliver the three broadcast networks out of Denver to as an accommodation and on which we lose a substantial amount of money.

We own the company that distributes WTBS to the back yard dish business and we are a packager, with probably—I am going to guess—a 10-percent market share of back yard facilities. Frankly we went into that business because we did not want to see price gouging in the delivery of video services to the back yard industry. If that happened we thought you guys would be all over our neck.

So we deliberately went into that business to make sure that the pricing was fair and evenhanded and that there was access. There was one place you could call which you could get all this programming. The business is not profitable, by the way. It is break even at best.

Senator **Pressler**. Thank you, Mr. Chairman, I have to make a quorum in Foreign Relations this morning.

Senator **Inouye**. We currently have rules in place limiting foreign ownership of broadcast stations. Should we extend these rules to other media sectors?

Mr. **Paxton**. I must confess, I have not really thought that one through, senator. I think it depends upon the amount of competition that is available in the marketplace.

Senator **Inouye**. Mr. Malone?

Mr. **Malone**. I believe in fairness. I think we should be treated fairly in the international marketplaces. I think with respect to cable or other information distribution mechanisms, there may be some strategic national policy issues there that go way over my head, but certainly we should be entitled to fair treatment and reciprocity at the minimum in those areas.

It certainly bears looking at, because in most foreign marketplaces we are not dealt with fairly and do not have reciprocity.

Senator **Inouye**. You have indicated that you do business in several countries. How do they treat you? Can you own broadcast stations there, or cable systems there?

Mr. **Malone**. It really varies enormously from country to country. In the U.K., of course, up until quite recently we were limited to 20 percent ownership. They found that they could not attract capital under that scenario and they relaxed those standards to some degree.

Senator **Inouye**. What is it now?

Mr. **Malone**. I think in the U.K. it is now unlimited, although they constantly present you with the prospect that they will reimpose it, so who knows? And there is a strict limit on the amount of U.S. programming content that we can distribute, so this is way over my head.

I think this comes into the whole area of international relations and equity and fairness on the one hand, as far as a trade issue goes, and as a national security issue I would certainly think that we do not want foreign control of our principal news and programming gathering sources.

Senator **Inouye**. In listening to your testimony, I could not help but hear you say several times that your industry has the lowest return for investors.

I do not want to think we want to give the impression that it is a nonprofit organization. Your organization is one of the most successful, and you have plowed back most of your income into expansion and capital improvement. Just for the record, could you tell us how much your stock was worth, say 10 years ago, and what it is worth today?

Mr. Malone. Well, I think I read a published report the other day that of all publicly traded securities we had had the most capital appreciation. I believe that we have gone from roughly 7/8ths of a dollar in 1977—when incidentally I had to hand the keys to the office to the banks that were about to close us down.

We have split the stock 12 for one and we have distributed to our shareholders several businesses that did not fit. If you add it all up, probably somewhere around 900 to one in terms of the appreciation of the capital value of the company.

But we have never distributed any dividends and our retained earnings are miniscule, almost nonexistent over the years. I might say, furthermore, that our company is controlled and heavily invested in by its employees. We have very low turnover. Our employees control the company and we all believe deeply in the business and the services that we provide and so we are all willing to let everything we have roll along with the business.

In a world in which I think everybody can be accused of short-term thinking, we have tried very hard to take a very long-term view with respect to our company and its various constituencies.

Senator Inouye. I have several other questions and if I may I would like to submit them to both of you for a response.

Senator McCain? Senator Gorton? If not, gentlemen, I thank you very much. It is very seldom we have witnesses on a panel testifying for over two hours and I think that indicates the depth of our interest and concern and we thank you very much for your participation.

Mr. Malone. Thank you, sir.

Mr. Paxton. Thank you, Mr. Chairman.

Senator Inouye. Our next panel is made up of Professor Ben H. Bagdikian of Berkeley, Professor Michael Salinger of Columbia University and Professor Barry R. Litman of Michigan State University.

The Committee is most grateful to all three of you for setting aside your time with us this morning. As you have noted in our questioning, there is much interest in this subject in this Committee, and so we look upon you to give us technical advice and recommendation?

If I may begin, may I call upon Professor Bagdikian.

STATEMENT OF PROF. BEN H. BAGDIKIAN, UNIVERSITY OF CALIFORNIA AT BERKELEY

Mr. Bagdikian. Thank you, sir. I thank the members of this Committee for the invitation to testify. If I may, I will summarize my prepared statement.

About ten years ago, when I started keeping track of growing concentration of ownership in the media, it was sufficient to read annual reports. Today if you miss the morning paper you can lose touch. So the pace is quickening.

There are three interlocked forms of concentrated control that are increasing. One, of course, is the growth of control by a relatively small number of firms over a single medium. In 1940, for example, in daily newspapers we had about 1,600 owners; by 1988, two-thirds of those owners had been bought up or taken over and of those remaining about a dozen had half of all national circulation and most of their papers are local monopolies.

And the magazine business is an example of the rapidity of this trend. In 1982 there were about 20 firms with half or more of magazine revenues, and today I believe that has shrunk to perhaps three or four firms.

In broadcasting there has been an increase in the number of radio stations, television has added a fourth network, but if one takes revenues of all 9,000 commercial radio stations and 1,000 commercial television stations, the three largest firms still have a third of all the business and the seven next-largest firms have only ten percent.

In book publishing, the shrinkage in market leaders has also been drastic. Despite the existence of more than 2,500 firms in the United States that publish one or more books a year, about a half dozen companies have half or more of the business. If we assume that most of the business is 50 percent or more, then the remaining approximately 50 percent of the national market is shared by some 2,490 smaller firms.

Cable is also rapidly concentrating. There are more than 9,000 operating systems in 25,000 communities, but the two largest firms have more than a third of all subscribers, with the rest divided among more than 200 smaller firms.

The second kind of control is cross-ownership. Newspapers and broadcasters have a high degree of common ownership, and some of those cross-owned firms are also dominant in magazines and book publishing; television and cable systems increasingly are in the movie and TV production business.

I believe cross-ownership reduces diversity. Studies show that commonly-owned TV and newspapers in the same market narrow the range of total news available in those communities. Furthermore, it shrinks access of the public to the continuing arguments on this issue.

A study at Brigham Young University showed that before the newspaper industry invested heavily in broadcasting the overwhelming majority of newspapers editorialized strongly against deregulation of broadcasting. The study looked at the papers today, after newspapers have bought into the broadcasting business; now the same papers editorialize strongly in favor of deregulation.

This reversal, of course, could have come from a collective religious experience, but the real point is that, whatever the cause, in the process the American public lost access to one-half of the argument on this issue.

A third kind of growing control is the strategy of most large media firms to have dominance not just in one medium and not just cross-ownership of different media, but to add ownership of the whole array of technical delivery systems from which the public gets its news, information and entertainment.

When this vertical integration is carried to the conclusion larger firms have in mind, we would have a series of closed systems. Dominant firms control most of the content of our mass media, such as origination of news, information, creation of broadcast and cable programming, production of motion pictures, copyrights to music, and these same firms also control the major delivery systems—like wholesalers for magazine distribution, radio and TV stations, cable systems that deliver the music and other programming, record companies that deliver their music, and the theater and videocassette firms that deliver the motion pictures.

The firms work toward what they call "synergy", and the advantages of a "guaranteed audience". It seems to me that under old-fashioned antitrust principles that could be called exclusion of competition by possession of a captive audience.

If we assume that we want a maximum of diversity and competition in our media, then I believe the social costs of vertical control are high. Independent and smaller companies tend to be squeezed out of the marketplace. For example, the major cable companies prefer programming they own and consequently are less interested in independent productions. It is market power with anticompetitive consequences.

When Rupert Murdoch's news corporation bought "TV Guide", the country's most widely-circulated weekly magazine, he told the "Wall Street Journal" that this would give him a stronger argument to persuade supermarket counters and news stands to give his other magazines more display space.

In this we are seeing history played backward. In 1948 the U.S. Supreme Court found common control of movie production and national theater chains a violation of antitrust law and the studios were forced to divest. Today, 40 years later, movie studios again are buying theater chains and now they and TV programmers control one-third of all movie screens in the country.

Let me conclude with what I believe are two different ways of looking at this scene. One way is to be impressed with the very large number of media outlets available to the American public and to trust new technology and the free market to increase competition and keep entry open to new players and new ideas.

And the numbers are impressive. There are 1,600 daily newspapers, at least 11,000 different magazines, 9,000 commercial radio stations, 1,000 commercial TV stations, at least 2,500 book publishers, and 9,000 cable systems. And it is true that in recent years new technology has opened new markets through devices like cable, VCRs and videocassettes.

But I think there is another way to look at the same scene. That view believes that the media are not just another industry; it is one that informs and socializes our population. Because of what this means in choices for democracy, I think we should be moving always toward maximum diversity in ownership and maximum choice of programming for the public, and not away from it.

This view sees the extraordinary numbers of media outlets, when controlled by a few very large firms, not as a comfort but as cause for alarm because it is excessive private power—communications power, economic power, and political power. This view believes that it is not a coincidence that as oligopoly has increased so have prices to consumers, so have profits, and so has uniformity of content.

It seems to this view that new media technology has emerged, but in almost every case, in a relatively short time the new entrepreneurs, the new ideas, and the new approaches have begun to disappear and the owners of the older media have become the owners of the new media, and the new media output has become more like the output of the older media.

Cable, once the hope of enormous diversity and an alternative to television, is increasingly the same in content as through-the-air broadcasting. And we see that the deregulation argument in broadcasting seems not be working. Since cancellation of the Fairness Doctrine, public affairs programming has dropped 51 percent.

Obviously, I subscribe to the second view. It seems to me that almost all the trends are discouraging. In 1945 the United States Supreme Court, in the Associated Press case, confirmed what has been the basic assumption of free expression in our democracy.

The Court stated that the First Amendment "rests on the assumption that the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public." It is that essential condition, diverse and antagonistic sources, that I think we are losing.

Thank you.

[The statement and questions and answers follow:]

Statement of Ben H. Bagdikian, University of California at Berkeley, before the Commerce Sub-Committee on Communications, the Committee on Commerce, Science, and Transportation of the United States Senate, June 14, 1989.[1]

I thank the members of this committee for the invitation to testify this morning.

Three assumptions are the basis of my view of the country's mass media.

The first is that to the greatest extent possible these media should reflect the nature, the needs, and the desires of the American public. We have an enormous number of media outlets in this country. We also have a richly diverse society. There ought to be some relationship between the two.

My second assumption is that our best hope for this diversity in the mass media is diversity of ownership and genuine free competition.

The third basis on which I judge these things is that minimizing government intrusion into the content of the mass media is best done by business law and regulation directed at size of economic power within each medium and in separation of ownership across different media.

On these grounds, the current trends in ownership are all in the wrong direction. With few exceptions, our major media are coming under the control of a decreasing number of very large firms, with, I believe, a not-coincidental loss of diversity and breadth of service to the public.

There is an unfortunate cause-and-effect relationship between increased market domination by a few firms and a decrease in diversity. As firms become larger, they take fewer risks and engage in fewer innovations. Most of the time, their large size itself means that places them under greater pressure for not only increasing cash flow and earnings, but for using content that will attract the attention of the same maximum audience the other market dominators also are engaged in reaching. Our experience tells us that whether we are dealing with automobiles or news and entertainment, when large firms compete for the same audiences, the result is increasing uniformity and imitative products. Innovation, experimentation, and specialization tend to be the specialties of small firms. Yet, in our mass media these qualities are essential if we are to have any relationship between diversity of our society and the output of our mass media.

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[1] This statement is the opinion of the author and not necessarily of the University of California.

Consequently, there is an irony in the impressive numbers of our media outlets. We have 1600 daily papers, at least 11,000 different of magazines, 9,000 commercial radio and 1,000 commercial television stations, thousands of book publishers, and 9,300 cable systems with thousands of individual channels.

If we had one owner for each of these units, the diversity of content, the choices available to every different individual and every particular citizen group in our society would be enormous. It would be a creative and competitive diversity and the public would have real choices. But we do not have all those owners with their individual approaches and goals. Instead, in our major media---newspapers, magazines, radio and television, books, and movies---we have increasingly a small number of dominant firms. Fewer than two dozen firms control half or more of all the business combined in all daily newspapers, all magazines, all of broadcasting, all of books, and all of motion pictures. Under these circumstances, we no longer have safety in numbers. Instead the numbers, being under tightening control, become disturbing. We have gained in total communications power, but that power is being held in fewer and fewer hands.

Three kinds of control are growing.

First, there is increasing market control within each medium.

Second, there is also a growth of cross-ownership in all the media. This compounds the first trend because what used to be competing media are more and more under common ownership. For example, the newspaper industry once competed with the broadcasting industry in offering the public differing news and opinion on communications policy, and in special interest lobbying within government. On those grounds, they are now allies and not competitors. Even their content, though in different forms, grow more alike with each passing year.

Third, there is growth in vertical control by a single firm over every step in each medium. The aim of almost every major mass media firm is to acquire control of an original manuscript, program, recording, screenplay, television series, or motion picture and to use that same basic material in all the other kinds of media the same firm owns. If independent or separate writers or producers or studios should attempt to find outlets, they find that increasingly the large firms are buying ownership of media delivery systems in which they prefer material they control. It may make for good for quarterly earnings but it does not make good public policy.

* * *

Market control by a few dominant firms within each medium is now characteristic of the national media.

In 1960 there were almost 1800 daily papers in the country, with 1300 different owners. In 1986 there were only half as many owners. In 1960, there were 61 cities with competing daily newspaper managements, in 1986 there were 28.[2] By now, the number is smaller.

Today, of cities with daily papers, 98 percent have monopoly managements. And of the almost 63 million average daily circulation, fourteen firms have half or more of the national circulation.[3]

The speed of this concentration is accelerating. In the magazine industry, for example, only seven years ago 20 firms had half or more of all the magazine business. Today I believe that there are only three firms.[4] Some analysts think there are only two, Time Warner and Rupert Murdoch's News Corporation.

In radio, the number of stations has increased and the field is shifting from AM dominance to AM-FM combinations that broadcast the same programming. Even with the growth of numbers of stations, a few large firms are emerging here, also. As we know, if we consider diversity of content, most of the 9,000 commercial radio stations broadcast in a dozen or so fixed formats and within each format the content, regardless of city, usually is the same, often actually automated.

In television there is a growth in the number of stations, but despite some loss of audience and emergence of a fourth network, the three major networks still have two-thirds of the audience.[5] As we know, network programming also is highly imitative.

Advertising Age tells us that if we combine all broadcasting---including radio and television---the three largest firms have 33 percent of all the business. After that, the next seven firms have only 10 percent, and each of the hundreds of smaller firms below that obviously have tiny shares.[6]

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[2]. John C. Busterna, "Trends in Daily Newspaper Ownership," Journalism Quarterly, Winter, 1988.

[3]. Average for six months ended September 30, 1988, based on Audit Bureau of Circulations and company records, tallied by the John Morton Newspaper Newsletter.

[4]. Author's calculation, published in The Media Monopoly, 1987 Revised Edition (Boston: Beacon Press) and updated for the present.

[5]. Based on current Nielsen ratings of prime time.

[6]. Advertising Age, December 26, 1988, p.12. The published tabulation, under "Top Ten Broadcast Companies," used revenues for 1987. I have used broadcast revenues for that year to

In the book business, fewer than a dozen firms have most of the business. Some who defend diversity in the book publishing business insist that there is no problem because there are 25,900 book publishers cited in Books in Print, 1988-1989, the standard reference published by R.R. Bowker (a Xerox Corporation firm). But these are publishers of the 781,000 titles listed in that reference work, including titles published by foreign firms and some whose books remain available but were published many years ago. If, however, there is insistence on using the 25,000 figure, the domination of the book trade by a handful of firms becomes even more extreme than I have calculated, since the market power of half a dozen firms with most of the business against the rest of the field divided by 25,000 is more alarming.

The more relevant figure for book publishing, I think, is about 2,500 firms, which is approximately the number of United States publishers that in any one year issue one or more books. I believe that today there are six firms with half or more of all the American book business.[7]

In terms of market control, there is little comfort in the fact that six firms may have half the business, and 2,494 firms have to divide the rest among them. Each of the dominant giants and each of the 2,494 others in the business is free to march into the headquarters of B. Dalton and Walden book chains and demand window displays and the front table of each store for its latest books, and each is free to buy full page ads in the New York Times Book Review. But only the large dominant firms have the economic power to get positive responses. The smaller competitors do not. It is a reminder of Anatole France's remark that the law in all its majesty gives to the rich and the poor equal freedom to sleep under the bridges of Paris.

The movie industry continues to be dominated by three or four firms.

(I have used the measure of those firms that have at least half of the revenues in their industry. I believe that is a useful way to measure market domination if the remaining half of the industry revenues is scattered among a large number of smaller competitors. The fact that there may be 2,500 or more firms that issued one or more books a year does not mean much in terms of market power, or in terms of ease of entry for new firms, if there are 2,494 pygmies, each trying to compete with six giants in purchase of manuscripts, mass production, access to national and international distribution systems, advertising and promotion resources, influence with major retail outlets, and large-scale lines of credit.)

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calculate share of industry business by the top three and the next seven corporations by size of revenues.

[7] BP Report, November 3, 1986, with updating by the author for subsequent mergers and acquisitions.

If one adds the dominant firms in all the major media, and takes into account cross-ownership by firms that are among the dominant ones in more than one medium, we come out with less than two dozen corporations that have half or more of the business in the combined revenues of daily newspapers, magazines, broadcasting, books, and motion pictures.

That may be a conservative figure. Concentration grows, sometimes daily, with yet more mergers and acquisitions. But it is also conservative if one looks at general revenues for all the media combined. If one counts only total revenues for all the mass media, 17 firms have half or more of all the business.[8]

In cable, there are 9,300 MSOs and about 48 million subscribers. There are about 250 firms in cable television, but three firms have a third of all subscribers.[9]

These dominant firms in each major medium have now spread their ownership into formerly competing media, with negative results in competition and in choices presented to the public. It is called "synergism" in the corporate world, with one firm's media using and promoting its contents in another medium that it also owns. Rupert Murdoch's Fox television network, for example, uses films and programs from his Twentieth-Century Fox studios. It is always a business advantage to deal with yourself in business, instead of an independent creator of content, but it is seldom a benefit to the public or to the independent companies, writers and program producers. Thus, as we get new technology that creates new outlets---like cable, VCRs, and direct satellite broadcasting----instead of new content and increased competition, we more and more add to the communications power of the existing firms. And since they own other media, more and more they propagate the same old content in a different medium.

Cross-ownership increases uniformity of news and opinion in the country and denies relevant information to the public. Let me give an example. In the past, very few newspaper companies were in the broadcasting business. A study at Brigham Young University showed that back then the daily newspapers were heavily against the deregulation of broadcasting, or else they were indifferent to the issue. They were, in effect, a different public policy and news voice. They acted as a watchdog on the broadcast industry's lobbying, even as the broadcasters were a watchdog on the newspaper industry lobbying. And the public benefitted from these differences. Each side probably was self-serving in arguing the pros and cons on the issue of deregulation of broadcasting, but in the absence of philosopher-kings in the ownership of our media (an unrealistic absence I do not mourn), an adversarial relationship is the most reliable method we have in getting both sides into the national discourse.

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[8] Advertising Age, cited above.

[9] Broadcasting and Cable Yearbook 1989.

The Brigham Young study shows that in editorials and public argument, newspapers in the past insisted that measures like Fairness Doctrine and Equal Time were necessary to prevent abuse in a protected monopoly. The newspapers had no problem with denying full First Amendment rights to broadcasters, since broadcasters enjoyed a government-protection of their frequencies, permitted no unlicensed competition, and, most newspapers editorialized, since the public owned the airwaves it was natural to demand that this monopoly be required to do some public service in return.

On their side, the broadcasters argued the opposite. They are businesspeople and they own fabulous cash boxes in the form of the government license, and of course they preferred not to do public service, like airing local issues and giving free time to the community since each minute of public service was a minute of lost commercials. It was not that the broadcasting industry was, or is, in economic trouble---apparently its profit levels are at least as high as they were before and probably higher---but like all people in business, given a choice of fabulous profits and even more fabulous profits, naturally they would choose the greater. Furthermore, given the profits and influence in owning a broadcast license, the owners would like to have as many licenses as possible. Limitations on ownership seemed to large firms, and I assume to the latter-day FCC, a violation of the free market. The broadcasters and the contemporary FCC have emerged with the intriguing concept of a free market in a licensed monopoly.

The point is that one way or another, in the past the American public heard the arguments on both sides of this issue.

Then the newspaper owners themselves began investing in these fabulous cash boxes. Not only were the profits even higher than in the newspaper business, but what could be sweeter than buying into your competition and having that wonderful situation in which you can't lose? Suddenly, the newspaper industry changed its mind about deregulation of broadcasting. The Brigham Young study shows that after newspaper publishers had invested heavily in broadcasting, they reversed their positions in their newspapers---88 percent favored deregulation of broadcasting. They thought deregulation of broadcasting was wonderful and discovered that they had been wrong about what they now called First Amendment Rights for broadcasters. In their new incarnation, the newspapers gave the public very little of the arguments against deregulation.[10]

I believe that during the most recent debate on this issue, one could listen to many hours of broadcasting news and public affairs documentaries, and one could read all the mainstream daily papers without receiving anything approaching a coherent and balanced set of pros and cons. What you heard from both,. if you heard anything at all, was one side of the issue.

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[10] Journalism Quarterly, Autumn, 1986, A. Pratte and G. Whiting, p497+.

So we had a reversal of policy. Part of that reversal of policy was cancellation of Fairness Doctrine. And what has that accomplished? In the argument over deregulation, the broadcasters and a majority of newspapers insisted that Fairness Doctrine inhibited broadcast treatment of public affairs in their programming, including community issues. The broadcasters and newspapers insisted that it was unreasonable and onerous to be subject to public complaint about alleged unfairness in treating public issues in special programs other than the news. The broadcasters, with most newspaper agreement, said this was what held back public affairs programming on the air. Relieve us of this unreasonable regulation, they said, and we will be free to air public issues. So they were relieved. A study released several few days ago by the Essential Information project shows the results: since suspension of the Fairness Doctrine there has been a 51 percent decrease in the average percentage of issue-oriented public affairs programming between 6 a.m. and midnight. The study looked at 217 stations in 50 markets.[11]

That study is no surprise to some of us who believed that the real reason there was not much public affairs programming on commercial television had less to do with Fairness Doctrine and more with the fact that you can make more money with syndicated game shows.

A third change in concentrated ownership is vertical control by the dominant media firms. The large ones all have said they now aim for control, on one hand, of the creation of content---like magazine articles, book manuscripts, screenplays, copyrights to music and movies, and syndication rights to television programs----and on the other, the means of its delivery to the public---the magazine distribution wholesalers, licenses for radio and television stations, ownership of movie theaters, record label systems, and videocassette production.

In daily newspapers, in most cities, ownership of both the product and control of its delivery system has been traditional. Radio and television licenses usually depended on outside producers, either network affiliations or syndicators, for their content. In the magazine business, there has always been competition, as there is in the book business, for the favor of wholesalers and distributors for prominent space in supermarkets, and newsstands. They all had access to a common carrier, the postal system, though increased rates have made this a less accessible delivery system.

It is symbolic of the trend that in the past the motion picture industry once owned its own delivery system. Each major studio had its own national theater chain so that in each city of any size it had a guaranteed audience for its films and could keep out movies made by others. But in 1948, the United States

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[11] Shortchanging the Viewers, Broadcasters' Neglect of Public Interest Programming, by Jim Donohue, copyright, 1989 by Essential Information, Washington, D.C.

Supreme Court declared common ownership of motion picture production and theaters a violation of anti-trust law and the movie studios were forced to divest. It rejuvenated the American movie industry and let the public for the first time have a choice of movies made by all the major studios as well as those made by independent producers and foreign film-makers. The major studios didn't like it, but they were forced to compete for business and for public acceptance.

Today that public choice is disappearing again. Major magazine owners are buying distribution companies. Hachette, a major magazine publisher in the United States, has bought the Curtis Circulation Company, the second largest magazine distribution system in the country. The major movie studios once again are buying control of theaters; they now own more than a third of all movie screens in the country. Major record companies are buying copyrights to vast libraries of classical and popular music. I am not suggesting it, but this morning should we all break out with the song, "Happy Birthday," we would, technically, have to pay The Time Warner Corporation a royalty fee.

Similarly, the major cable companies increasingly insist on owning a financial interest in shows and programs they use on their cable channels, and since in most cities, the cable system is a local monopoly, they have total control of content, on their terms, both as to the producers and in choices presented to the cable audience.

These developments are producing a series of closed circuits, open mainly to a relatively small number of firms who regard the American public as an entity to be frozen in choice. They call this development of "a guaranteed audience." A more descriptive term could be "captive audience."

Even when there is no direct ownership of a delivery system, market dominance by a few large firms means squeezing smaller operators out of the competition to show their wares to the public. There is not much question about the ability of Time Warner and Murdoch's News Corporation to insist on the best display for their publications at supermarket checkout counters and newsstands, compared to the others in their industry, or of the major book publishers on windows displays and shelf space in chain bookstores.

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The rapid trend toward market domination, cross-ownership and vertical control diminishes the functions the mass media as a whole ought to play in a democracy.

The first characteristic is that the individual citizen should be free to read, watch or listen to whatever is available, without fear of punishment. We have no problem with that in this country.

A second characteristic should be to reflect something of the rich diversity of citizen groups, of locales and regions, of ethnic and class interests, of the enormous variety of our local social and political life. Cross ownership and vertical control are limiting that function. We see this in the similarity in our newspapers and in network content. In the book business, the big firms have reduced their variety of kinds of trade books published. Cable increasingly repeats what through-the-air television produces. The fact that the same large corporations are more apparent each year as major operators in what used to be competing media intensifies this growth of uniformity.

Lastly, modern media represent a way different parts of our public deal with each other and see each other. A truly democratic mass media system ought to have the highest possible access by its citizens and citizen-groups to that system. Public and political groups are increasingly closed out of the intake to our mass media machinery. The entrepreneurs in the media with few exceptions have a business advantage in selecting their own content for many reasons. Sometimes it is a prime social function, like the professional selection of news. But other times, it is an advantage for maximizing profits, since public affairs programming and public access programs on television and cable is less profitable than entertainment shows that will attract commercials. So left to their own devices, there will be as little public access to our broadcast and cable system as can be arranged by our commercial broadcasters. That is growing even in non-commercial broadcasting now that it has become dependent on corporate support. It took an act of Congress, not the marketplace, to take a first step in maintaining some place in broadcasting for independent producers.

Some years ago, the FCC mandated a Prime Time Access hour in which local stations were not to use standard network programs but were expected to use that prime time hour to do what the Communications Law said they should do, meet strictly local needs. Unfortunately, the FCC did not pursue it. Instead of using that prime time hour for local community programming, most stations used syndicated game shows and the like, in which they could sell commercials and keep all the proceeds.

The problem of market dominators in all the media will not go away by itself. In this field, the free market philosophy has produced not more competition and diversity in the mass media but less. The basic reason is not a mystery. A few years ago, the advertising firm, Backer Spielvogel Bates, studied 2,746 firms over a four-year period. As reported in the Financial Times of London, for January 12, 1989, this study found what should not surprise us:

A firm with sales volume 1.5 times its nearest competitor, is 52 percent more profitable than its nearest rival, and 183 percent more profitable than all the rest of the market. Market leaders averaged 31 percent return on investment compared with 11 per cent for companies ranked fourth or worse. The report stated that in order to enjoy these higher profit levels, it was not necessary to have superior quality.

Market domination to this extent is a problem in any industry, but in the media it has severe social consequences. I believe that it is not coincidental that as market domination has increased in the mass media, so have profit levels and so has uniformity and cheapening of content. It is something Adam Smith would recognize: monopolists enjoy higher profits and control over quality of the product. And without intervention, it is self-perpetuating. Today average daily newspaper pretax profit margins vary between 20 and 40 percent, in television higher than that. Cable fees are rising annually at double the rate of inflation and production costs. So we are not dealing with industries undergoing economic suffering. I believe that they have become so used to monopolistic profits that they are alarmed when there is the prospect of real competition. It has been noted that even though, over the years, the television industry has had declining share of audience, the industry steadily increased its advertising rates.

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Where there is regulation, as there is in broadcasting, I think the Federal Communications Commission ought to get back into the business of implementing the letter and the spirit of the Communications Law.

In the process of deregulating broadcasting we have heard a great deal about the sanctity of First Amendment rights for broadcasting. I have spent much of my career as a professional beneficiary and supporter of the First Amendment. Because of that, not despite it, I am puzzled by this insistence that we are dealing with it in regulation of broadcasting. Let me describe my problem with it:

We all know that the First Amendment says government shall not abridge the right of free expression. Yet, if I and a moderately talented teen-ager next door set up a radio transmitter in my garage and begin giving my news and announcements to whomever wishes to listen, the government will order me to cease and desist. If I do not I will be subject to seizure of my garage and equipment and face possible penalties of $250,000 fine and five years in prison. As you know, precisely such cases have occurred and have been prosecuted. The broadcasting industry insists on such government police action against uninhibited competition. I would suggest that if full First Amendment rights are to be extended to broadcasting, then let broadcasters accept full First Amendment behavior which means that you or I or anyone else can broadcast without let or hindrance.

Historically, it was the broadcasting industry that insisted on being regulated. They did it for a very good reason because uninhibited competition on the airwaves, which used to exist, produced chaotic jamming and wild changes that were not in the public interest.

The Congress on behalf of the whole society made a contract with broadcasters. The government would use its police powers to forbid any unlicensed person to broadcast, and would forbid anyone, licensed or not, from intruding on the frequency of the broadcaster. The other side of that contract was that in return for this extraordinary protection, the broadcasters would be selected to avoid conflicts of interest, would be required to do categories of public service, to attend to the needs of the communities over which their license extended, and to be subject top periodic review and challenge if there was evidence that they did not live up to their side of the contract.

In recent years, the Federal Communications Commission has moved to wipe out one side of that contract. The Commission has blessed a strange marriage between the free market philosophy and a protected monopoly.

I believe that the FCC should get back into the business of implementing the spirit and the letter of the Communications Act. Among other things, that means examining license applications for conflicts of interest and anti-competitive effects. Twenty years ago the FCC found that ITT was not an appropriate buyer of the ABC network and its stations because of its history and its potential conflicts of interest in the news. But today, somewhat the same kind of transaction was approved quickly when General Electric bought NBC.

The whole principle of license transfer needs to be changed. Diversity of ownership should be the goal. The FCC has adopted the reverse by permitting enlarged license possession by owners. Mandated public service in general categories left up to the station, should be reinstituted, including Fairness Doctrine and Equal Time. Licenses once more should be subject to challenge by community groups in the media, instead of the current practice which comes close to possession in perpetuity.

Cross-ownership should be forbidden across the board. I realize that the Commission has let the genie out of the bottle so that now you have powerful interests in other media in possession of licenses they will not only work to keep but work to keep a genuine debate out of the news and other public discourse. No new licenses should be issued to any owner who has interests in other media, not just newspapers. A date should be announced by which divesture of current cross-ownership will be ended, a move made by the Commission years ago and then abandoned.

Cable ought to be reregulated top achieve two goals. It needs to be divested of cross-ownership. And there has to be an effective way to adjudicate the growing public complaint about runaway fees and poor service. The ideal cable system, in my opinion, is to create cable as a common carrier that, like the electric and telephone industry, is rewarded by maximizing its accessibility, not the present situation in which cable monopolies are rewarded by reducing access. That opportunity was lost many years ago, but some rule is needed to keep systems open and responsive to subscribers, the great majority of whom are stuck with a local monopoly.

The idea that the public should have access to their airwaves has been all but lost. It would surprise most Americans to know that in the Netherlands, for example, any national group with a given level of membership is automatically granted airtime. And that some other countries have high quality, non-politicized public television through funds based not on appropriations and executive action but on fixed electronic equipment taxes.

There are many social costs we have paid for removing the idea of public service from broadcasting. One of them has been what it has done to our political system, which shows the effect of unrestrained commercialization of broadcast programming and the weakened sense of obligation for public service. Domination of our campaigns by broadcasting has raised the cost of running for public office to absurd heights and its freedom to achieve entertainment goals even in political campaign programming has diminished substance and reflection from the national political discourse. Today, the main ingredients of campaigning, certainly for national and statewide office, have been reduced to the profit maximization and audience collection of broadcasters, not to the country's need for public information. The chief element is now the 5-second, 10-second, or 30-second campaign commercial.

I believe that the American political process, and the ability of this country to make intelligent choices in public policies and political leaders, would be enormously enriched by two modest proposals.

1. All paid political campaign commercials ought to be banned from radio and television.

2. And for two months before every national and state election, serious blocks of prime time ought to be given free by every radio and television station to every political party that polled five percent or more in the previous election.

There will never be an end to sloganeering and emotional manipulation in politics, and it is in the nature of the political animal that rhetorical and symbolic manipulation will always be with us. But nowhere is it written that what has become the American public's primary method of political education should deal almost exclusively in these least useful elements in our political discourse, or that the broadcast systems that benefit by their licenses should do nothing for the public in return.

In the non-broadcast media, the goal again should be diversity of ownership. That means stricter application of anti-trust law in a number of ways. In daily newspapers, for example, it is necessary to recognize that in 98 percent of our daily newspaper markets, it is a local, not a national market. But anti-trust practice continues to look at the scene nationally, which means that today a firm owns more than 100 newspapers, each a monopoly, but because this is not a dominant percentage of the national market, it is permitted without inhibition and keeps adding monopolies.

In all media, mergers and acquisitions should be judged more severely and with cross-ownership a negative factor in approval.

We are not dealing here with manufacturers of blue jeans and soft drinks. The mass media socialize each generation, in some ways more than do parents, schooling and religious training. By the time an American child is 16 he or she has spent more time in front of a TV set than in a classroom. He or she has seen perhaps 300,000 commercials and at least 80,000 murders.

In looking at all our media, print and broadcast, what has this dilution of anti-trust principles produced? For one thing, it has produced a generation of Americans who no longer know that there is anything they can do about the national scandal of children's programming. They do not realize that their parents could and sometimes actually did challenge the renewal of broadcast licenses of stations that ignored local needs or cheapened quality by excessive commercials. The result has been that each year broadcasting is more suffused with every possible permutation of violence and other attention-getting devices like gratuitous sex and sexism.

In newspapers, it has produced now almost two generations who are surprised that their grandparents had three or four or five competing local daily papers to choose from, and that these papers had differing social, political and cultural approaches.

We rightly fear government intervention in the form of censorship. Or government ownership or domination of our mass media. But we have an alternative. We have free enterprise traditions that are meant to apply to all industries, which is to forbid monopoly and oligopoly through anti-trust law and works to give the public a maximum of choice.

Thank you.

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS

Question. 1. What are the economies/synergies in operating multiple cable systems (horizontal integration)? Do these economies exist only when there is clustering of systems in a particular community?

Answer. A. Economies of scale/synergies in horizontal integration of cable systems.

The operator of a number of local cable systems enjoys a number of economies of scale and synergies, I believe. One is in administrative overhead and access to favorable credit. Another is bargaining power in contracting for independently produced programming, since the more subscribers under the control of one firm, the more that operator will be able to exclude an independent program producer from a portion of the national market if the producer does not accept the terms of the multiple system operator. As we know, increasingly this has meant that the larger cable operators insist on being granted ownership shares in programs they adopt for their systems. The multiple operator also can more economically promote particular programs regionally and nationally. Lastly, by control of a number of local systems, the multiple operator can and is in a position to deny access to larger numbers of subscribers for any reasons, commercial or otherwise, that the operator desires.

B. Do these economies exist only in clustering of systems in a particular community? I am not certain of the meaning of this question, since competitive systems within any particular community is so rare that I think it is not a serious factor.

Question 2. What are the economies/synergies in owning both the source of programming and the distribution outlet?

Answer. Economies of scale/synergies in owning both programming source and distribution outlet.

The chief benefits to the operator who owns both content and conduit are two. The operator has a guaranteed audience for whatever programs the operator owns. The operator can exclude any programs that the operator wishes to exclude for competitive or other reasons. Since cable systems are almost entirely local monopolies, these advantages are close to absolute.

(There is some reason to believe that many MSOs with own content and conduit begin their local services with a wider variety of programming in order to attract subscribers to the original wiring of the city. Once that city is wired, and the cable operator has the local monopoly, there is a shift to programming in which the operator has an interest of one kind or another, and to that extent it reduces that operator's responsiveness to the subscribers who are then limited to the only system available to them.

Question 3. In broadcasting, when new stations are available, we give the first shot to applicants who do not own other stations to increase the diversity of ownership. Do we need to strengthen this policy? Should we extend this policy?

Answer. Should preference for new broadcast licenses continue to go to applicants who do not own stations.

A. Yes. The policy should be strengthened to make it absolute. Profit levels of individual stations are high and there is no need to increase concentration in order to make possession of a license viable. Since the 7-7-7 rule was expanded to 12-12-12, the price of licenses has risen dramatically. This means that such licenses are profitable enough to attract new applicants. It also means that unless a one-to-a-customer policy is adopted for broadcast licenses, that stations will become the possession solely of the most powerful corporations, further limiting new entries and reducing accountability that comes from genuine ownership competition.

B. Should one-to-a-customer be extended to other services. Yes. There are extremely high profit levels for individual daily newspapers, individual radio and television stations, and individual cable systems. There is no need to further reduce diversity by permitting higher concentrations of ownership.

Question 4. There appears to be a trend of programming migrating from over-the-air-television towards cable. Why is this occurring and will it continue?

Answer. Migration of TV programming to cable. Why is it happening?

A. One reason it is happening is that there is increasing ownership of cable systems by through-the-air broadcasting and other program producers, and there are economies of scale in reusing existing programs. There is also exploitation of name-identification and popularity of through-the-air programs. I believe that there is another reason. Because of relaxation of the must-carry rule, cable systems have become competitive for the same programming of through-the-air systems in their locality, and while this is short-sighted (given the through-the-air origin of most popular programs), it is an incentive for a cable system to drop a station whose TV series or network series the cable system plans to run.

Question 5. Will local news be the next service to migrate to cable?

Will local news migrate to cable?

Answer. I think it will do so only on a superficial level. A news operation comparable to those in most affiliated TV stations and the more successful independent ones is expensive to create and continue, compared with syndicated entertainment. Local news is place-specific and time-specific, so it cannot be syndicated or re-run. Therefore local news is without the economies of scale that redound to the present cable systems that have dominant positions in the national market.

Question 6. If not, how will this affect local television stations?

Answer. If not, with what effect on local TV stations. Studies show that when there is head-to-head competition between through-the-air stations, it results in more local news. Local news is expensive but popular, so stations increase it only when they have to. Adoption of news by cable might increase competition between cable and TV stations and therefore stimulate more local news on television stations. But I believe that it will not be a serious development or at least not of substantial local news because of the cost to the cable system and because it is unique as to time and community.

Question 7. Radio programming is often talked about as the most local medium, but what about the growth of automated programming from national networks?

Answer. The growth of radio stations has not been reflected in any serious increased diversity of programming. Since the FCC ceased to consider formats for radio licensees, there has been increased automation of programming at many stations in any given system. Even when not technically automated, the content is essentially standardized for any one format. There are some advantages for the listener in the average market of having a choice of radio stations within a given format (hard rock, soft rock, talk, classical, etc.) but these are limited. If radio is to be "the most local medium," then the FCC must return to consideration of license transfers or new licenses with one criterion the number of stations within the market that already exist in each format. The FCC should give extra consideration to license applications that will increase the format choice within the market.

Senator INOUYE. Thank you very much, Professor.

Professor Salinger.

STATEMENT OF PROF. MICHAEL A. SALINGER, COLUMBIA UNIVERSITY

Mr. SALINGER. Thank you, Mr. Chairman and Members of the Committee. It is indeed an honor for me to be here today.

I have recently undertaken a study of joint ownership of pay cable services and cable systems, which is why I gather I was asked to be here today. Time, Inc. owns both ATC, the second-largest multiple system operator, and HBO and Cinemax. Viacom is a large multiple system operator and it owns Showtime and the Movie Channel.

Vertical integration of this sort creates concerns that the systems will deny access to competing services. This cost must, however, be weighed against the benefit that a service is more likely to be provided by a system that owns it. If ATC provides Cinemax when another system would not, that is a benefit, all else equal.

I do not know if you have access to my written statement, but if you look on page two of it there is some evidence on these costs and benefits.

That table shows the frequency with which different types of systems provide the four major pay services. Not surprisingly, both ATC and Viacom provide the services they own more frequently and the services they do not own less frequently than do unintegrated systems.

Is that good or bad? The ATC and Viacom systems do not provide fewer pay services on average than do unintegrated systems. If they did then that might be taken as evidence that the vertical integration was bad.

However, the ATC systems are more likely to provide exactly two services than are unintegrated systems. That is, they are less likely to provide no pay services or only one pay service, but, by the same token, they are less likely to provide more than two pay services. Moreover, the two services they do provide are more likely to be HBO and Cinemax, the services they own, than is the case with other systems.

Because of exclusive contracts between movie studios and pay services, I suspect that those who subscribe to the two services would generally prefer HBO and Showtime to HBO and Cinemax.

Before jumping to the conclusion that joint ownership of pay services and cable systems is harmful, however, one needs to examine the evidence concerning Viacom cable systems. They are more likely to offer the combination of HBO and Showtime than are unintegrated systems.

I believe, therefore, that it would be a mistake to outlaw joint ownership of cable services and cable systems. The evidence is mixed on whether such links are beneficial. Moreover, there may be ways of attacking the vertical integration when it is harmful while allowing it to exist when it is beneficial.

First, the antitrust laws can be used to attack mergers which extend vertical links that seem harmful, and, in extreme cases, to sever vertical links that are clearly harmful.

Second, the potential for vertical integration to be harmful would disappear if a locality could switch franchisees if it was dissatisfied with its choice of services. One might look at offerings of a particular vertically-integrated system and judge that they are less desirable than the offerings of other systems.

If it was known, however, that a franchising authority chose to refranchise such a system when it could have switched to a different operator, then there would be a presumption that the offerings of the vertically-integrated system were at least as good as the offerings of the alternatives. Vigorous competition at the refranchising stage would limit a cable system's ability to exploit any market power that it has.

As such, Congress might consider repealing the provisions of the 1984 Cable Act that limit the factors franchisors can consider at both the franchising and refranchising stage.

Thank you.

[The statement and questions and answers follows:]

Testimony of Michael A. Salinger before the Senate Commerce, Science, and Transportation Committee, Subcommittee on Communications, June 14, 1989

One of my primary research interests over the past five years has been the effects of vertical integration. One part of that research has been a study of vertical integration between cable systems and the providers of pay cable services,[1] which I will describe to you today. I want to emphasize that this research is still in progress, and I do not pretend to have a definitive answer to the question of whether vertical links between cable systems and pay services are desirable. I can, however, report to you some evidence and some conjectures about how the evidence should be interpreted, which I hope can help guide the Committee in its deliberations.

Time, Inc. owns 82% of American TV & Communications Corporation (ATC), the second largest multiple system operator (MSO), and HBO and Cinemax, the largest and third largest pay services. Viacom is one of the ten largest MSO's, and it owns Showtime and The Movie Channel (TMC), the second and fourth largest pay services.[2]

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[1] Salinger, Michael A., "A Test of Successive Monopoly and Foreclosure Effects: Vertical Integration between Cable Systems and Pay Services," September, 1988, mimeo.

[2] The only other pay service with nearly as large a subscribership as these four is the Disney Channel. Because its programming is aimed primarily at children, it is likely to be less of a direct competitor for HBO, Showtime, Cinemax, and TMC than these four services are for each other. Accordingly, I chose not to study the effects of vertical integration on provision of the Disney Channel.

In my study, I collected data for a sample of 30 ATC systems, 26 Viacom systems, and 198 systems[3] operated by the other 18 of the largest 20 MSO's. I compared the frequency with which each type of system offered HBO, Showtime, Cinemax, and TMC. The results are given in the following table:

TABLE 1

Percentage of Systems Providing Each Pay Service

System Type	HBO	Cinemax	Showtime	TMC
ATC	100	80	57	20
Viacom	88	31	88	62
Others	93	58	67	43

Recall that ATC, HBO, and Cinemax are jointly owned and Viacom, Showtime, and TMC are jointly owned. HBO and Cinemax are provided on a greater fraction of the ATC systems than they are on unintegrated systems. On the other hand, Showtime and TMC are provided on a smaller fraction of ATC systems than on unintegrated systems. Showtime and TMC are provided on a greater fraction of Viacom systems than on unintegrated systems. However, HBO and Cinemax are provided on a smaller fraction of Viacom systems than on unintegrated systems. The basic lesson of Table 1 is that, not surprisingly, vertically integrated systems give preference to the services they own and tend to exclude competing services.[4]

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[3] The original data set contained 200 unintegrated systems, but two observations had to be discarded because of missing data.

While diagnosing the effects of vertical integration is relatively easy, whether it should be considered desirable is less clear. ATC's link with HBO and Cinemax hurts Showtime and TMC, just as Viacom's ownership of Showtime and TMC hurts HBO and Cinemax. At least to a first approximation, however, the damage to the rivals is not a public policy concern.[5] Rather, the issue is whether the offerings of the vertically integrated systems are more or less desirable to consumers than are the offerings of the unintegrated systems. From this perspective, vertical integration would seem to have both costs and benefits. The additional provision of HBO and Cinemax (Showtime and TMC) by ATC (Viacom) systems is properly understood as a benefit, which needs to be weighed against the cost of less provision of Showtime and TMC (HBO and Cinemax). The key question to be answered is whether the benefits exceed the costs.

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[4] One has to be careful about using these raw fractions, since other features of the systems might explain some of the variation. See Salinger, op. cit., for estimation in which other factors are controlled for. The Viacom systems tend to be large and in large television markets. These conditions are conducive to the provision of more service. Nonetheless, the general result that vertically integrated systems are more likely to offer the services they own and less likely to offer the services they do not own holds even when these other factors are taken into account.

[5] The exclusion of competing pay services by vertically integrated systems might reduce the incentive of the foreclosed service to increase the quality of its offerings, which in turn might make it less competitive in other markets. As a theoretical matter, I believe this issue might be important; but I have no evidence as of yet to show that it is.

Table 2 presents evidence on the total number of major pay services offered by the different types of systems.[6]

TABLE 2

Average Number of Top Pay Services

System Type	Average No. of Top 4	Average No. of Top 2
ATC	2.57	1.57
Viacom	2.69	1.77
Others	2.61	1.60

The first column shows the average number of the four major pay services (HBO, Showtime, Cinemax, and TMC) provided by each type of system. The ATC systems on average provide somewhat fewer of the pay services while the Viacom systems provide somewhat more, but the numbers are so close that they can be viewed as being virtually identical to each other. In the two pairings of the pay services, HBO and Showtime are the premiere channels while Cinemax and TMC are secondary. Column 2 shows the average number of the premiere channels offered by each type of system. The figure for ATC is virtually identical to the average for unintegrated systems. The figure for Viacom is somewhat higher, however.

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[6] The data in this table and the last column of table 3 were compiled for this testimony. In contrast to the data in table 1 and the rest of table 3, estimation in which other factors are controlled for does not appear in Salinger, op. cit.

While the average number of services provided is of interest, it at best provides evidence on the average effect of vertical integration. If the only policy options are to ban all vertical links or to permit all of them, such evidence might be all that is useful. The view that vertical integration is always beneficial or always harmful is, however, an oversimplification. Some deeper insight into the effects of vertical integration can be gained by examining the percentage of different types of systems providing at least two, at least three, and all four of the pay services, as well as the percentage providing both of the premiere services. These data are presented in Table 3.

TABLE 3

Provision of Multiple Pay Channels
(Percent)

System Type	At Least 2 of Top 4	At Least 3 of Top 4	All of Top 4	HBO & Showtime
ATC	97	47	13	57
Viacom	88	58	22	81
Other	86	56	22	63

Virtually all of the ATC systems provide at least two pay services, while only 88% of unintegrated systems do. The ATC systems are, however, less likely to provide at least three and all four of the services than are unintegrated systems. Also, while ATC systems are more likely to provide at least two pay services, they are less likely to be the two premiere pay services. The data on the average number of pay offerings, in which ATC systems are about comparable to unintegrated systems, mask a more subtle effect. The ATC systems are more likely than unintegrated systems to offer exactly two pay services and those two pay services are more likely to be HBO and Cinemax than is the case with unintegrated systems. What is interesting about the data for the Viacom systems is the greater frequency of offering both HBO and Showtime. This finding is, of course, consistent with the result in Table 2 that the Viacom systems offer on average a greater number of the premiere services.

In assessing these data, a key issue is the value of having a choice among all the services. If the services were nearly identical to each other, then it would not matter if ATC systems offered primarily HBO, Viacom systems offered primarily Showtime, and unintegrated systems were mixed. Stop 'N Shop does not sell Grand Union cola and Grand Union does not sell Stop 'N Shop cola. That sort of foreclosure is not troublesome, though, because Stop 'N Shop cola and Grand Union cola are probably close substitutes for each other, and they both face competition from Coke, Pepsi, and Royal Crown.[7] If the services are sufficiently different, though, that some people might want both or some people might have a strong preference for one over the other, then some of these results are more troublesome. The offering by many systems of all the services suggests, of course, that either some people want all of them or have preferences for one over the other. Moreover, there is a compelling reason why some people would want more than one. It is now standard for HBO/Cinemax and Showtime/TMC to have exclusive contracts (for some period of time) for the cable display of recently released movies. In order to get the full complement of recently released movies on cable, one must subscribe to HBO and Showtime.

What, then, should we make of the above results? They certainly do not constitute a blanket condemnation of vertical links between MSO's and cable services. The increased likelihood of being able to subscribe to at least two pay services on the ATC systems and the increased likelihood of getting both HBO and Showtime on Viacom systems strike me as being real benefits. The evidence that I have collected so far is not adequate to support the claim that the costs of vertical integration exceed the benefits.

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[7] Another reason that this foreclosure is not troublesome is that any consumer with a strong preference for Stop 'N Shop cola can shop at Stop 'N Shop rather than Grand Union. Foreclosure at a single outlet is less troublesome when there is competition among outlets. I will return to this point below.

By the same token, the results do suggest that vertical links create problems in some cases. In particular, the tendency of HBO systems to provide HBO and Cinemax and no other pay services strikes me as being troublesome.

The natural question to ask is whether there is some way to minimize the costs of vertical integration when they arise without giving up the benefits. There may be. The antitrust laws make it possible to attack harmful vertical integration while leaving beneficial vertical integration intact.[8] The proposed merger between Time and Warner strikes me as raising serious antitrust concerns. Because Warner used to be part owner of TMC, most Warner systems carry it. Many of them also carry Showtime, and very few of them carry Cinemax. A natural concern about the merger is that Cinemax is going to replace Showtime and/or TMC on the Warner systems. I do not know how carefully The Justice Department examined the vertical aspects of the Time/Warner merger. My impression is that they do not take foreclosure arguments seriously. In any case, the Justice Department could have made divestiture of the Warner cable systems a precondition for not challenging the merger. My point is that if this merger results in harmful vertical integration, the laws to prevent it are in place.

A general principle is that the harmful effects of foreclosure are mitigated by competition. If cable systems had no market power, their failure to offer particular services would be of no concern. One of the premises of the 1984 Cable Act, which greatly loosened the regulatory constraints on cable operators, was that cable systems face a considerable amount of competition. Broadcast television, video-cassettes, and movie theaters are arguably the most direct competitors. More generally, all forms of entertainment provide some competition. Cable is not a necessity in the same way that electricity or water is. If prices are high enough and service is bad enough, people simply will not subscribe. Nonetheless, I simply am not persuaded that competition from other modes of entertainment is so strong that market power in cable and attendant foreclosure is not a concern.

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[8] I do not want to minimize the problems in distinguishing between the two.

Another source of competition is system overbuilds. If a locality is dissatisfied with its cable operator, it has the power to license a competing system. This solution to poor service is very expensive. Cable television is a natural monopoly.[9] The use of telephone company fiber optic cables to carry television signals into the home is a possible source of competition, but it is a short run solution at best. If telephone companies are allowed to operate cable systems or lease their cables to cable systems, I doubt that competing cables whose sole purpose is to provide cable television will be maintained, replaced, or upgraded. The fact that in many areas, two groups of cables go into homes does not make the solution efficient.

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[9] See Noam, Eli, "Local Distribution Monopolies in Cable Television and Telephone Service: The Scope for Competition," in Noam, Eli (ed.), Telecommunications Regulation Today and Tomorrow (New York: Harcourt Brace Jovanovich), 1983.

Direct broadcast satellites (DBS), multipoint distribution systems (MDS), and multipoint multichannel distribution systems (MMDS) have the potential to compete with cable. Because the dishes to receive DBS are expensive and MDS and MMDS do not exist in most areas, these sources of programming are not currently significant constraints on all cable systems. Any one of them has the potential to alleviate foreclosure effects associated with the relatively small number of existing pay services. Showtime is presumably indifferent between entering homes through cables or having people pay descrambling fees. Thus, one possible approach to alleviating foreclosure effects is to remove any regulatory barriers to competing technologies.

Insofar as something other than regulatory constraints is holding up competing technologies, then Congress might consider other ways of stimulating competition. One possibility is to foster more competition at the refranchising stage. The 1984 Cable Act creates a strong presumption that the incumbent system will have its franchise renewed; and it prevents high prices or poor programming selection from being grounds for changing franchisees. In a series of recent papers,[10] Mark Zupan has argued that MSO's have generally performed well in order to establish reputations for good service. Such a reputation is valuable, he argues, in the bidding for new franchises. As the number of new franchises dwindles, this incentive will weaken. However, if there were active competition at the refranchising stage, the incentive to maintain a reputation for good service would survive. It is certainly possible that no matter what Congress does, vigorous refranchising competition will not materialize. Nonetheless, Congress might reconsider the barriers it has erected to vigorous refranchising competition.

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[10] See Zupan, Mark A., "Reneging by Cable Operators on their Franchise Promises: Opportunism or Economic Necessity?," November, 1987, mimeo; "Franchise Bidding for Natural Monopolies: How well does it Promote Efficiency in Local CATV markets?," January, 1988, mimeo; and Zupan, Mark A., "Cable Franchise Renewals: Do Incumbent Firms Behave Opportunistically?," April, 1988, mimeo.

Policies concerning joint ownership of cable systems and cable services cannot be considered independently of policies designed to elicit more competitive behavior by cable systems. I am less impressed than most by the constraints on cable systems and would urge Congress to try to stimulate competition for cable operators. If it succeeds in doing so, I believe that the concerns about vertical integration are likely to vanish. Even if more competition is not practical, however, the evidence that I have so far does not justify a ban on the joint ownership of cable systems and cable services.

Answers to post-hearing questions of Senator Inouye by Michael Salinger

Q. What are the economies/synergies in operating multiple cable systems (horizontal integration)? Do these economies exist only when there is clustering of systems in a particular community?

A. Economists distinguish between real and pecuniary economies. The former represent the savings or more efficient utilization of real resources and should generally be considered social benefits. The latter represent transfers from one party to another. They are a benefit to the recipient but they are not social benefits. In evaluating the gains to a system from multiple system operation, it is important to keep this distinction in mind.

The cost of system-originated programming is largely fixed. Multiple system operation makes it more likely that it is profitable for a system to incur that cost. Of course, it is possible for a system that produces programming to sell that programming to another system, so multiple system operation is not necessarily essential for systems to originate their own programming. Nevertheless, multiple system operation probably facilitates system-originated programming. If the programming in question is of primarily local interest (i.e. locally originated programming), this benefit (to the system) of multiple system operation concerns clustered systems. If the programming is of more general interest, the benefit (to the system) is not restricted to clustered systems. Whether this benefit to the system should be considered a benefit to society turns on the issues I have already discussed about the desirability of vertical integration.

Joint operation of systems makes it possible to share the costs of program evaluation and negotiating with providers of services and other inputs into cable operation. These represent real savings. In addition, multiple system operation increases a system's bargaining powers. Most of the advantage of increased bargaining power is pecuniary.

There are some savings in headend expenses from joint operation of clustered systems. A single headend can only directly service an area with a radius of about 5 miles. With clustered systems, however, a hub system of headends can be used; and channel origination, processing, switching, and monitoring only have to be performed at the master headend. These savings probably represent a small fraction of the costs of operating a cable system.

Q. What are the economies/synergies in owning both the source of programming and the distribution outlet?

A. There are not many real economies in owning the source of the programming and the distribution outlet. The primary effect of joint ownership is that it alters a system's incentives concerning the choice of programming and, perhaps, pricing. Joint ownership is beneficial when it results in the provision of a service that viewers want and that would not otherwise be provided. It is harmful when system owners substitute the services they own for services that viewers prefer.

Q. In broadcasting, when new stations are available, we give the first shot to applicants who do not own other stations to increase the diversity of ownership. Do we need to strengthen this policy? Should we extend this policy to other services?

A. By "other services," one of the possibilities you may have in mind is cable systems. I think it is impractical to give priority to newcomers in cable. The days of single system operators are probably behind us. I think that it would be desirable, all else equal, to have a relatively large number (10-20) of relatively large MSO's. This sort of structure would make it possible for there to be meaningful franchise and refranchise competition. Of course, for such competition to occur, Congress must amend the 1984 Cable Act or the FCC must change the definition of "effective competition."

Q. There appears to be a trend of programming migrating from over-the-air-television towards cable. Why is this occurring and will it continue?

A. Cable provides the opportunity to charge for television service. Some programming migrates to cable to take advantage of that opportunity. Charging for programming is not an unmixed blessing. The direct revenues are obviously a benefit. However, fewer people watch cable and, as a result, advertisers are willing to pay more for slots on broadcast television. I think that the trend will continue as more people subscribe to cable, but it is not clear how far it will go. There is concern that the day will come when one will have to subscribe to cable to see the World Series, the Super Bowl, and the Olympics. I do not think that it is obvious that cable will be able to outbid broadcast television for these big events, but it is not unforeseeable.

Q. Will local news be the next service to migrate to cable?

A. I doubt it.

Q. If not, how will this affect local television stations?

A. There are several possibilities. Television might provide better news to try to attract viewers. It might provide less news because it has less money to spend on it. It might have no effect. I appreciate the concern for maintaining news outlets, but I think that the claims about the effect of cable on broadcast news are so speculative that they should not be major considerations in formulating cable policy. Rather, the aim of policy should be to insure that cable systems provide the services that people want at a reasonable price.

Senator INOUYE. Thank you very much, Professor.
Professor Litman.

STATEMENT OF PROF. BARRY LITMAN, MICHIGAN STATE UNIVERSITY

Mr. LITMAN. Thank you. I appreciate the opportunity of being here.

Senators, at precisely the same time that the marriage of computers and space age technologies has launched a communications and information revolution, we have witnessed the haunting spectre of increasing concentration of ownership and control over these important sources of information and entertainment.

These two parallel trends seem closely linked together; yet, paradoxically the explosion of new technology generally acts as a deconcentrating force—opening up markets to new entry by those pioneers who can visualize old problems in different ways and respond with innovative and efficient products that obsolesce the status quo. Far from being a centripetal force pulling an industry closer together, new technologies should create competition as they redefine and expand industry boundaries.

What then is the true explanation for this unlikely trend towards concentration? We are told by the advocates and apologists for the current wave of mergers that a new age has dawned where inter rather than intra-industry competition is the norm, where international rather than national markets prevail, and where state-sponsored trade barriers have replaced free trade.

In this new era, traditional notions of competition are too risky and unpredictable. Only the mega-sized firm, with its total dedication to efficiency and productivity, can hope to compete on the new world stage.

We are also told that mergers are the perfect tool for growth, for quickly enhancing the company's public image and for achieving the necessary efficiencies through synergism, while antitrust is pictured as an archaic tool of a bygone era, a nuisance that impedes rather than aids the cause of business.

The most successful mergers are those where all the pieces, "all the parts seem to fit together." Never mind that the concept of synergy is seldom fully defined and often is a code word for obtaining greater control over one's suppliers and customers through vertical integration.

Never mind that the unproven assertions of increased efficiency frequently turn into broken promises and broken dreams as corporate raiders discover that the sum of the parts is worth more than the whole.

The solution to these shortcomings is to install a stronger management team accompanying an even larger merger, and so the concentration syndrome continues and feeds upon itself.

Senators, this vision of modern day corporatism is a blueprint for a vertically-integrated, cartelized American economy, populated by self-reliant mega-firms under the leadership of a cult of charismatic personalities. From my perspective, the answer is not to continually "up the ante" by permitting larger and larger mergers under the guise of creating world competitors or foreclosing foreign takeovers.

Public policy should take a more sensible approach to large mergers by placing the burden of proof for greater efficiencies on those who propose these mergers rather than forcing those who evaluate the mergers to prove the opposite.

This problem of merger mania and concentration of ownership and control is especially important in the mass media since many scholars believe that these industries help shape and should preserve an open marketplace of discourse. I have prepared a series of tables charting trends in concentration among three unregulated industries—that is, industries which have operated with impunity during the benign enforcing era of the antitrust laws.

These industries are motion picture exhibition, daily newspapers and cable television systems. All these industries demonstrate rising levels of concentration over the last five to ten years.

The proponents of mergers in these mass media would argue that it is wrong to look at national concentration indices because these products are available only at the local level. Since cable and newspapers are de facto local monopolists, no additional monopoly power can be transferred to the national level and hence chain ownership is largely irrelevant from an economic viewpoint.

While this view is indeed true, that some chains typically do not compete with each other nationally, this analysis misses the point that the programming featured by these local outlets, whether they are newspapers, cable systems or motion picture theaters, is overwhelmingly national in scope, whether it is wire service copy, theatrical motion pictures, or premium and basic cable networks.

With chain control over the local outlets for this national programming comes a strategic flexibility, and the strategic flexibility is the power to determine access to the local audiences across the country. This power becomes even more important when such decisions as what the American people will see are influenced by vertical integration and self preference between the exhibition and distribution stages.

The Time-Warner merger, from my perspective, is symptomatic of the problems of historic firms in adjusting to the new competition. While the principals in this merger argue for synergy, what synergy really means is a reduction of risk and uncertainty through guaranteed access to subsidiary markets or what we call windows.

Lest we forget the lessons of the past, it was this assured access and accompanying self-sufficiency which was the core of the action against AT&T and the Paramount conspirators. It was also the reason for the passage of the financial interest and syndication rules and earlier chain broadcasting rules limiting network vertical integration into adjacent strata.

Unless a line is now drawn, this spiral of increasing concentration and control, homogenization of content, and rising prices will continue unabated.

Thank you.

[The statement and questions and answers follow:]

STATEMENT OF BARRY R. LITMAN, PROFESSOR OF TELECOMMUNICATION, MICHIGAN STATE UNIVERSITY

My name is Barry Litman. I am a Professor of Telecommunication at Michigan State University. For the last dozen years since earning my doctorate in Economics, I have studied the changing structure of the telecommunication and mass media industries in the United States, with particular emphasis on the impact of mergers and market concentration.

Senators,

At precisely the same time that the marriage of computers and space age technologies has launched a communications and information revolution, we have witnessed the haunting spectre of increasing concentration of ownership and control over these important sources of information and entertainment. These two parallel trends seem closely linked together; yet, paradoxically, the explosion of new technology generally acts as a deconcentrating force--opening up markets to new entry by those pioneers who can visualize old problems in different ways and respond with innovative and efficient products that obsolesce the status quo. Far from being a centripetal force pulling an industry closer together, new technologies should create competition as they redefine and expand industry boundaries.

The late economist, Joseph Schumpeter, labelled this disciplining force of new technologies, a "gale of creative destruction" which threatened the positions of power of those firms who clung to the old ways and lived the "quiet life" rather than engage in research and development.

What then is the true explanation for this unlikely trend toward concentration? We are told by the advocates and apologists for the current wave of mergers that a new age has dawned where inter rather than intra industry competition is the norm; where international markets and state sponsored trade barriers are prevalent. In this new era, traditional notions of competition are too risky and unpredictable; only the mega-sized firm with its total dedication to efficiency and productivity can hope to compete on the new world stage.

We are also told that mergers are the perfect tool for growth, for quickly enhancing the company's public image and for achieving the necessary efficiencies through synergism while antitrust is an archaic tool of a bygone era, a nuisance that impedes rather than aids the cause of business. The most successful mergers are those where "all the parts fit together." Never mind that the concept of synergy is seldom fully defined and often is a code word for obtaining greater control over one's suppliers/customers through vertical integration. Never mind that the unproven assertions of increased efficiencies frequently turn into broken promises as corporate raiders discover that the sum of the parts is worth more than the whole. The solution to these shortcomings is to install a stronger management team accompanying an even larger merger. And so the cycle continues and feeds upon itself.

Professor Walter Adams has insightfully examined this trend toward bigness which is permeating all of American industry and has chided government officials for believing that bigness is the "secret alchemy for inducing productivity, innovation and international competitiveness" and questioned whether these new monopoly giants "are the new Promethians bringing the heavenly gift of technology from the celestial abode and placing it in the service of mankind."

Senators,

This vision of modern day corporatism is the blueprint for a vertically integrated, cartelized American economy populated by self-reliant mega-firms, under the leadership of a cult of charismatic personalities who seem more interested in arranging for golden parachutes, protecting their companies against unfriendly takeovers and selling their autobiographies than in serving the public interest. The answer is not to continually "up the ante" by permitting larger and larger mergers under the guise of creating world competitors or foreclosing foreign takeovers. Public policy should take a more sensible approach to large mergers by placing the burden of proof for greater efficiencies on those who propose them rather than forcing those who evaluate the mergers to prove the opposite.

The problem of "merger mania" and concentration of ownership and control is especially important in the mass media since many scholars believe that such industries help shape and should preserve an open marketplace of discourse--the heart of any democratic system of government. I have prepared a series of tables charting trends in concentration among three unregulated industries, that is, industries which have operated with impunity during the benign enforcement era of the antitrust laws. These industries are: motion picture exhibition, daily newspapers and cable television systems.

During the last five years in the motion picture exhibition business, the level of concentration among the top 4 and top 8 theater circuits has risen by a magnitude of 50%. While this industry still would be considered competitive, the voracious appetite of such mega circuits as United Artists, AMC and General Cinema when combined with the reintegration of many of the major motion picture distributors sends a clear-cut warning for future concentration problems. In fact, the reintegrated majors now have more screens under their collective control than when they were broken up after the Paramount decision! Concentration at the exhibition level would be even more severe if the industry were not growing by some 1000-2000 new screens a year as part of the shopping mall phenomenom.[1]

The same acquisition trend has occurred in the daily newspaper industry, although to a lesser extent. While daily circulation has remained relatively constant since 1965, such major chains as Gannett, Thomson and the New York Times have recently increased their merger pace and relative national standing.

In contrast to the stagnant newspaper and theater industries, cable television has seen a remarkable growth rate since the mid 1970s when a series of favorable industry developments spawned the "cable revolution." In the face of such widespread growth, it is not surprising to see that concentration of control by the largest four or eight multiple system operators has proceeded at a slow pace until the last couple of years. Individual firms would have to grow even faster than the market to increase their relative market shares.

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[1] This phenomenom of theater expansion occurs paradoxically while customer demand (as measured by the number of admissions) has remained relatively flat for nearly two decades.

There has also been some difficulty in measuring market concentration in this industry because of the prevalence of jointly owned subsidiary firms with separate company names. Should each separately named firm be counted individually in compiling industry statistics (for example, the leading MSO, TCI, would then have only 4.4 million subscribers (8.9%)); should we include all the subsidiaries in which they have controlling interest (TCI would then have 11.1 million subscribers (22.5%)); or should we apportion the number of subscribers in these jointly owned MSOs according to the financial interest of the parents (in this case, TCI would have 8.6 million subscribers and a 17.4% market share). Using this last technique, it is clear that the level of national concentration in cable is rapidly approaching the threshold of what would be considered a moderately concentrated industry.

The proponents of mergers in these mass media would argue that it is wrong to look at national concentration indices because these products are available only at the local level. Since cable and newspapers are de facto local monopolists (and local motion picture theaters are generally controlled by a few chains), no additional monopoly power can be transferred to the national level and hence chain ownership is largely irrelevant from an economic viewpoint. While it is indeed true that such chains typically do not compete with each other nationally, this analysis misses the point that the programming featured by these local outlets is overwhelmingly national in scope, whether it be wire service copy, theatrical motion pictures, or premium and basic cable networks. With chain control over the local outlets for this national programming comes the power to determine access to the local audiences across the country. This power becomes even more important when such decisions as what the American people will see are influenced by vertical integration and self-preference between the exhibition and distribution stages.

If the Time-Warner merger is permitted, TCI and ATC will jointly control access to nearly 29% of all cable households. This would give them virtual veto power over which cable networks would be available and which would not. Time-Warner's combined ownership shares in several key networks such as HBO and Cinemax may exacerbate the problem that competing networks like Showtime-TMC allege in gaining equal access to these MSO subscribers. Furthermore, with the vertical ownership tie to Warner Brothers Studio (and its recent acquisition of Lorimar) and long-term exclusive contracts with most of the remaining major motion picture distributors, vertical barriers to entry into the pay-cable area would be heightened.

While the principals in this merger argue for synergy, what synergy really means is a reduction of risk and uncertainty through guaranteed access to subsidiary "windows." Lest we forget the lessons of the past, it was this assured access and accompanying self-sufficiency which was the core of the action against AT&T and the Paramount conspirators. It was also the reason for the passage of the Financial Interest and Syndication Rules and earlier Chain Broadcasting Rules limiting network vertical integration into adjacent strata. The FCC believed that the public interest meant that both TV networks and affiliates should make their programming decisions without regard to equity or long-term contractual considerations.

The Time-Warner merger is symptomatic of the problems of historic firms in adjusting to new competition induced by new technology driven programming services. Time's response is to seek to control such uncertainty by acquiring the competition and becoming the leader or second largest firm in all the areas in which it operates. The TV networks ask for a similar kind of protection by reestablishing their vertical ties to adjacent sectors through elimination of the Financial Interest and Syndication Rules. Unless a line is drawn, the spiral of increasing concentration and control, homogenization of content, and rising prices will continue unabated.

Table 1

Number of Screens for Top U.S. Theater Circuits,* 1983, 88

December 1988				December 1983			
Rank	Company	# Screens	%	Rank	Company	# Screens	%
1	United Artists	2,667	10.71	1	General Cinema	1,050	5.56
2	AMC	1,614	6.46	2	United Artists	1,005	5.32
3	General Cinema	1,400	5.60	3	AMC	736	3.89
4	Cineplex Odeon	1,167	4.67	4	Plitt	605	3.20
5	Loews	822	3.29	5	Martin	431	2.28
6	Carmike	701	2.80	6	Commonwealth	362	1.92
7	Ntl. Amusements	552	2.21	7	Mann	315	1.67
8	Hoyts	550	2.20	8	Redstone	302	1.60

Total U.S. Screens	25,000	18,884
4 firm Concentration Ratio	27.43%	18.0%
8 firm Concentration Ratio	37.93%	25.5%
Herfindahl-Hirschman Index	.026	.011

Source: Variety, Annual Editions.

Table 2

Market Shares for North American Film Distributors,* 1982-88

Company	1988	1987	1986	1985	1984	1983	1982
Columbia	9%	4%	9%	10%	16%	14%	10%
20th-Fox	11	9	8	11	10	21	14
MGM-UA	10	4	4	9	7	10	11
Paramount	16	20	22	10	21	14	14
Universal	10	8	9	16	8	13	30
Warners	11	13	12	18	19	17	10
Disney	20	14	10	3	4	3	4
Orion	7	10	7	5	5	4	3
Tri-Star	—	5	7	10	5	—	—
Embassy	—	—	—	1	<.5	1	1
Atlantic	na	na	1	1	1	.5	<.5
Cannon	na	na	2	2	1	<.5	<.5
New World	na	na	3	1	1	1	1
DeLaurentis (Embassy)	na	1	3	—	—	—	—
All Others	6	12	3	13	2	1.5	2
CR_4	58%	57%	53%	55%	66%	66%	68%
CR_8	94%	83%	84%	79%	91%	96%	96%
H-H	.12	.11	.11	.11	.13	.14	.16
CR_6-Majors	67%	58%	64%	74%	81%	89%	89%
Instability**	35%	21%	49%	37%	40%	39%	

*Market Shares = Percentage of annual film rentals to distributors

**Instability = $\sum_{i=1}^{N} S_i^t - S_i^{t-1}$ Source: Variety, Annual Editions.

Table 3

U.S. Newspaper Companies– 1988's 20 Largest

Ranked by Daily Circulation*

		Daily Circulation'	Number of Dailies
1.	Gannett Company Inc.	5,944,055	88
2.	Knight-Ridder Inc.	3,806,116	29
3.	Newhouse Newspapers	3,017,836	26
4.	Tribune Company	2,672,707	9
5.	Times Mirror Co.	2,607;655	8
6.	Dow Jones & Company Inc.	2,442,819	23
7.	Thomson Newspapers Inc.	2,081,893	120
8.	The New York Times Co.	1,857,927	27
9.	Scripps Howard	1,640,554	23
0.	Hearst Newspapers	1,438,435	14
1.	Cox Enterprises Inc.	1,310,167	20
2.	News America Publishing Inc.	1,091,751	3
3.	MediaNews Group	1,063,384	18
4.	Ingersoll Newspapers	1,051,550	37
5.	Freedom Newspapers Inc.	945,202	29
6.	Capital Cities/ABC Inc.	918,604	9
7.	Central Newspapers Inc.	825,275	7
8.	The Washington Post Co.	824,759	2
9.	Donrey Media Group	798,066	57
0.	Copley Newspapers	760,863	12

U.S. Newspaper Companies— 1979's 20 Largest

Ranked by Daily Circulation *

		Daily Circulation	Number of Dailies
1.	Gannett Co., Inc.	3,548,242	82
2.	Knight-Ridder Newspapers, Inc.	3,419,064	33
3.	Newhouse Newspapers	3,215,694	29
4.	The Tribune Co.	2,935,314	8
5.	Dow Jones & Co., Inc.	2,096,290	21
6.	Times Mirror Co.	2,064,575	7
7.	Scripps-Howard Newspapers	1,825,634	17
8.	Hearst Newspapers	1,390,643	13
9.	Cox Enterprises, Inc.	1,148,381	16
10.	Thomson Newspapers (U.S.)	1,088,908	67
11.	The New York Times Co.	1,031,608	10
12.	Cowles Newspapers	995,994	10
13.	Capital Cities Communications, Inc.	955,282	5
14.	News America Publishing, Inc. (Murdoch)	786,655	3
15.	Central Newspapers, Inc. (Pulliam)	756,828	7
16.	Freedom Newspapers, Inc. (Hoiles)	739,351	29
17.	The Washington Post Co.	711,525	3
18.	Field Enterprises, Inc. (Chicago)	675,995	1
19.	Evening News Association (Detroit)	671,471	4
20.	The Copley Press, Inc.	639,547	9

1988		1979	
CR_4	24.5%	CR_4	21.1%
CR_8	38.8	CR_8	32.9
CR_{20}	59.5	CR_{20}	49.3
Total Daily Circulation	62,955,502	Total Daily Circulation	62,223,040

*Average for six months ending September 30, 1988; September 30, 1978.

Table 4

TCI Holdings

MSO Name	TCI ownership %	No. of Subscribers	Weighted No. of Subscribers
TCI	100%	4,396,900	4,396,900
Storer	50	1,530,700	765,300
United Artists-- United Cable	52	2,626,729	1,365,899
Heritage	100	1,100,000	1,100,000
WestMarc**	100	554,389	554,389
TKR	50	268,195	134,098
Cencom	31	253,754	78,664
Lenfest	48	358,524	172,092
Hearst*	100	57,410	57,410
	Total	11,146,601	8,624,752
	Number of U.S. Cable TV Households	49,539,200	
	TCI Market Share	22.50%	17.41%

Weighted Number of Subscribers according to TCI's financial interest.

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*Proposed Merger
**Includes recent purchase of remaining stock.

Table 5

MSO Concentration Ratios,[@] 1969-89

Year	CR_4	CR_8
1969	16.3%	26.7%
1971	21.7	31.6
1973	27.2	40.3
1975	26.4	38.1
1977	23.1	34.2
1979	24.0	36.5
1981	27.3	40.9
1985	29.4	43.5
1986	28.2	41.5
1987(Fall)*	27.7	39.8
1988(Spring)**	27.6	39.4
1989(Spring)***	28.7	40.5

[@] All market shares are calculated by using separately listed MSO subscriber counts, even if the MSO is partially owned by a parent company.

*With 43 milliion basic cable households in the U.S.
**With 46 million basic cable households in the U.S.
***With 49.5 million basic cable households in the U.S.

Sources: Benjamin Compaine, Who Owns the Media? Revised Ed., 1983, p. 395; Cablevision, February 15, 1988; July 4, 1988; and May 22, 1989.

Table 6

1989 ADJUSTED MSO CONCENTRATION LEVELS
BEFORE AND AFTER TIME-WARNER MERGER

Before Merger			After Merger		
		Weighted # Subscribers			Weighted # Subscribers
#1	TCI	8,624,752	#1	TCI	8,624,752
#2	ATC	4,100,000	#2	ATC	5,647,000
#3	Continental	2,366,297	#3	Continental	2,366,297
#4	Comcast	2,218,300	#4	Comcast	2,218,308
	Total	17,309,349		Total	18,856,349
	CR_4	34.94%		CR_4	38.06%
#5	Warner	1,547,000	#5	Cox	1,453,000
#6	Cox	1,453,000	#6	Cablevision	1,354,936
#7	Cablevision	1,354,936	#7	United Artists-United Cable	1,260,830
#8	United Artists-United Cable	1,260,830	#8	Newhouse	1,145,000
	Total	22,925,115		Total	24,070,115
	CR8	46.28%		CR8	48.59%

Weighted Number of Subscribers according to parent company's financial interest. For example, TCI's number of subscribers includes 50% ownership of Storer, 52% ownership of UAC-United, 50% ownership of TKR, 31% ownership of Cencom, 48% ownership of Lenfest, and 100% ownership of Heritage, WestMarc and Hearst.

Source: Cablevision, May 22, 1989.

Table 7

Premium Pay-Cable Concentration

Network	No. of Subscribers (millions)		Market Share
Home Box Office	17.00		46.20%
+			
Cinemax	6.00		16.31

		Time, Inc.	62.51%
Showtime	6.60		17.94
+			
The Movie Channel	2.70		7.34

		Viacom	25.28%
Others			
Playboy	.47		1.28
Disney	4.00		10.87
American Exxxtasy	.03		.08

Total Premium Pay-cable subscribers* 36.79 million

*Does not include regional sports or pay-per-view networks

Source: Cablevision, March 13, 1989.

RESPONSES OF DR. BARRY LITMAN TO SENATOR INOUYE'S POST-HEARING QUESTIONS

Question 1—What are the economies/synergies in operating multiple cable systems (horizontal integration)? Do these economies exist only when there is clustering of systems in a particular community?

There is a certain logic in attaining chain ownership across multiple cable systems just like there is for grocery stores, drugs stores or the like.[4] There are pecuniary efficiencies which arise from being large and having some capability to negotiate quantity purchases with one's suppliers. These quantity discounts may be based on real cost efficiencies from transportation or distribution savings or merely a redistribution of income between the buyer and seller—the large buyer able to coerce the seller to reduce price or else risk losing the business. Since distribution in the cable industry is via satellite and is simultaneously transmitted, there is no need for multiple copies (as compared to theatrical films) and hence no real physical product is transported. Thus, quantity discounts do not really reflect more efficient use of scarce economic resources.

On the other hand, direct negotiations between an MSO headquarters and a cable network may result in significant transaction cost savings for both sides because a single deal involving a network "go ahead" can apply to several hundred local cable systems and millions of cable subscribers. In return for such access to local systems, program networks often give significant quantity discounts (in the price/subscriber) to the MSO.

There also are cost savings which arise from centralizing certain functions at the national level rather than locally; these include legal advice, management, strategic planning, lobbying, research and programming expertise.

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[4] The difference is that the MSO is a chain of local monopolies while the grocery or drug stores operate in monopolistically competitive industries.

Such costs are generally fixed and can be spread across the entire base of systems, thereby yielding the lowest cost per cable household. In this way, local systems get the benefit of expertise in many different areas that would certainly be more expensive to procure at the local level.

The real question is how large does the MSO have to be to fully take advantage of such centralized cost efficiencies and whether a threshold is reached where further additions to size yield declining or negative marginal efficiencies. This latter region is often referred to as diseconomies of scale. Such diseconomies arise when additional layers of bureaucratic fat add excessive costs, delay expeditious decision-making and/or stultify creativity. Of course, the flip side to efficiencies arising from additional size are market power considerations. There is nothing to compel the large MSO to pass along any of the cost savings to the local cable subscribers. Furthermore, while a chain of cable systems cannot add additional market power to that already present at the local level, national concentration of control over access may yield a strategic flexibility--the power to decide what program services the consuming public will see or not. When such horizontal power is coupled with vertical integration through equity ownership or long-term exclusive contract, such gatekeeper responsibilities may be influenced by self-preference (see question #2) and reciprocity between similarly situated MSOs.

If an MSO operates contiguous local cable systems, there may be some additional cost savings which accrue from regionalization of management, servicing, telecommunications, centralized procurement of equipment (like converters or remote control tuners) and more efficient coordination of advertising accompanying uniform channel numbering across systems. However, there is no definitive evidence suggesting there are economies of scale in laying the basic plant over larger geographical distances. In fact, because of signal attenuation, the farther out the plant stretches from the headend, the more amplifiers which must be cascaded and the greater necessity for adding remote hubs and microwave or fiber optic connections.

Question #2—What are the economies/synergies in owning both the source of programming and the distribution outlet?

This question really asks whether vertical integration is associated with certain efficiencies, that is, whether it is more desirable for firms to produce in-house or else acquire from the outside. Vertical integration is ubiquitous in most industries today! In one way or another, most firms will internally handle certain functions rather than contract with outside companies. The extent of such integration depends on the nature of the product itself; what functions the firm can more efficiently do for itself as compared to others; whether outsiders can be trusted for reliable and timely delivery of product; whether internal managerial expertise can transfer over to new and different tasks/functions, the ease in borrowing money at reasonable interest rates and the resulting debt-equity ratio of the firm; etc. Hence, there is no simple explanation why vertical integration works in one set of circumstances but not another. Vertical integration becomes a policy concern when entire stages of production (e.g., raw materials, manufacturing, wholesaling and retailing) are either eliminated from direct competition or foreclosed from access by existing or new firms due to excessive integration.

To judge the impact of vertical integration (both its pro-competitive and anti-competitive effects) across various levels of production, we need to know the following pieces of information:

a. The circumstances under which it was formed and the intent in which it was used. If it was formed to deny access/product to non-integrated competitors and/or to exclude them from their right to engage in commerce, it should be judged more harshly than if it was an expansion to achieve efficiencies or for a legitimate business purpose.

b. The degree of market power in the primary stage of production. The greater the degree of power, the greater the leverage that can be exerted over non-integrated rivals. This leverage can be used to deny access/product (product squeeze) from the secondary level. If there is no market power at the primary stage (monopolistic competition), then vertical integration creates no strategic advantage, flexibility or leverage.

c. Ease of entry in both the primary and secondary stages of production. To the extent that entry is relatively easy, then any strategic advantage or leverage created by vertical integration (even if the primary stage is very concentrated) will be short lived--it will easily be overcome through new entry.

d. Degree of Self-Sufficiency. To the extent that vertical integration creates self-sufficient (self-reliant) firms, they will find it easier to exert their power over unintegrated rivals. If firms are unintegrated or not fully integrated, they subject themselves to greater vulnerability from dealing with marketplace forces and becoming reliant on fully integrated suppliers/customers who may be their competitors at different stages.

e. Type of integration. Full equity ownership yields greater stability and control than partial equity ownership which in turn is superior to long-term exclusive contracts with independent companies.

f. Method of integration. Vertical integration by internal expansion (starting from scratch) creates a new competitive force in the secondary level and hence is preferential to vertical integration by merger which simply replaces an existing firm.

For the specific situation at hand, when a program distributor owns an exhibition outlet or vice versa, there is a natural tendency to self deal at the margins, if everything else is equal. This means that the vertically integrated company will prefer its own product over those of independent suppliers if the quality is comparable. This granting of preferred access may further enhance the status and value of the product in a subsidiary market. While such a system of self-preference is common across many industries, its implications are more ominous when the product is information and news, and especially, since the government has issued licenses to gatekeepers to judge the merit of what information is to flow or not to the American people.

Once again, vertical integration is not inherently evil, its effect critically depends on all the factors listed above, and arguably, may have pro-competitive impacts if the intent was to launch new programming services that were so risky that they would not have become available through normal competitive processes but required a type of preferred status through assured access. Thus, the major advantage of vertical integration across distribution and exhibition stages is the head start it permits a new program service in gaining universal penetration. This same issue parallels the commercial networks' ownership and operation of television broadcast stations where O & O's uniformly (and without exception) clear their parent network's programming. In either case, one must ask whether the benefits which the networks bring forth would be lost without assured access through vertical integration and whether the harm to the marketplace of ideas is substantial enough to risk structural surgery.

Question #3--In broadcasting, when new stations are available, we give the first shot to applicants who do not own other stations to increase the diversity of ownership. Do we need to strengthen this policy? Would we extend this policy to other services?

The diversity of ownership rules have proven to be a valuable weapon in preventing widespread horizontal acquisitions by media conglomerates. Since broadcast combinations lose their "grandfather" clause when ownership changes for whatever reason, acquisitions of major broadcast combinations are deterred for fear of having to sell off strong holdings within local markets. For example, when Capital Cities acquired ABC, there were many multiple outlet cities which resulted. Most notable was Detroit where the merged Capital Cities-ABC would have had multiple radio, newspaper and cable outlets. After nearly three years, the FCC granted waivers to Capital Cities-ABC from its diversity of ownership rules in those large cities with many broadcast outlets (the so called 25-30 rules). The same procedure was followed for Rupert Murdock's conflict in Boston when he purchased the Metromedia group. Since this liberal waiver policy only applies to the top 25 cities, it may not be seen as a green light to future large scale merger activity.

In general, I agree with the diversity of ownership rules as they apply to television stations and local newspapers--the two most concentrated local media. I don't believe that the arguments of economic efficiencies/synergies apply to local TV-newspaper combinations or TV-radio combinations anymore. With respect to cable-telco and cable-broadcasting, any relaxation of the rules is premature until it is determined how these services will fit into the future telecommunication mosaic and specifically whether cable is going to be reregulated in the near future.

My philosophical agreement with maintaining deconcentration of power in the local media markets does not mean that the FCC should automatically disqualify non-local applicants or those that are chain owned in favor of first-time applicants who have no previous broadcasting or media experience. The complexity of the media businesses today require intimate knowledge which often comes from previous experience in similar or parallel situations. Furthermore, the investment necessary to acquire an existing TV station in a major market or even launch a new station on a vacant frequency basically rules out the "mom and pop" stand-alone owners of a previous era. There are significant economies of scale which accompany a certain level of chain ownership. This is one reason for expansion of the multiple ownership rules to their current configuration of 12-12-12. Thus, I would not favor strengthening the diversity of ownership rules if the intention is to dissuade all but the novice businessperson.

With respect to the issue of having strict ownership limits on new services, while this has some visceral appeal, I believe there is a great danger in having excessive constraints while an industry is in the developmental stage. As in the patent process, entrepreneurs seeking to enter a new territory or innovate a new service may need a protected position until the market/product proves viable. However, after an industry has matured, then the spur of competition will yield superior performance and new rules can then be instituted to break down barricades to new entry. Also important in such entry decisions will be the nature of the required investment and minimum efficient size necessary to achieve all cost efficiencies, the risk involved, interest rates and the length of the investment horizon.

Question 4--There appears to be a trend of programming migrating from over-the-air television towards cable. Why is this occurring and will it continue?

To understand this migration process, one needs to recall that commercial television, and specifically networks, have a single source of revenues, namely, the sale of time to national advertisers. National advertisers are willing to pay so much money per 1000 households (or per 1000 people with certain attractive demographic characteristics) to expose their message and hopefully sell more of their products. Hence, the program is merely the bait to lure the mass audience which in turn is sold to advertisers in bulk on a cost/1000 basis. This system forces networks to choose mass appeal programming which in a sense "maximizes their ratings" since network revenues are critically dependent on the number of households or target people which watch the programs and the embedded commercials.

In more specific terms, the gross network advertising revenues per half hour of prime time equals the price per thirty second ad times the number of 30 second ads sold per half hour:

Gross Ad revenues = price/30 second ad x no. of 30s sold per half hour

Since the price per thirty second ad equals the price/1000 households that advertisers are willing to pay times the expected number of households, substituting in the equation above,

Gross Ad revenues = price/1000 H.H. x no. of expected H.H. x no. of 30s

For any period of time (say a TV season), the price/1000 H.H. advertisers will pay will be fixed as will be the number of thirty second ads per half hour. Thus, the only variation will occur with the number of expected households (the ratings). Shows with high ratings yield high revenues for the networks needed to cover their high costs of programming, commissions to ad agencies, satellite interconnection costs, network compensation and overhead expenses. Such profit-making shows will be renewed for subsequent seasons. Conversely, if a program's ratings are not high enough to generate sufficient revenues to cover these costs, it will suffer a loss and eventually be cancelled.

Over the last decade, the networks have seen their profit margins squeezed because: (a) programming costs have escalated due to increased demand and competition from new cable program services (b) network aggregate market shares[1] have fallen due to fractionalization of the audience by new cable programming, the Fox Broadcasting network, and a strengthened independent television sector (c) some national advertising revenues formerly earmarked for network television have been diverted to the cable networks and national barter markets (d) the price per 1000 households that advertisers will pay for network TV has stabilized compared to previous years of double-digit price increases and (e) the networks have not been able to increase the quantity of advertising time per half hour[2] for fear of losing additional audience to program services which are commercial free like HBO . This profit squeeze has most notably affected ABC and CBS, the second and third ranked networks.

On the other hand, cable and pay-cable networks operate with a different revenue generating process which is not as dependent on advertiser support as network television. Consumers pay a direct "a la carte" monthly charge for each premium pay-cable channel they desire. These channels do not have advertising and hence the total wholesale revenues that HBO, Showtime or Disney obtain (roughly 50% of the retail cable system price) must cover all their program and distribution costs and generate a profit. To illustrate this process for the individual program,[3] this would mean that the net revenues generated by direct consumer payment must cover all the production/distribution costs.

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[1] While network relative shares have fallen, it should be noted that the total number of households with television sets has simultaneously been increasing. Hence, while the networks' share of the market is smaller in percentage terms, the absolute number of households watching network TV has not significantly diminished. It is more correct to say that their "potential audience" has diminished.

[2] The networks have, however, split the available time into smaller units of 15 second spots, at about half the price of 30 second spots, but this has not stimulated additional advertising demand.

Network Revenues per program = net revenue per household x number of network subscribers

If the network revenues generated by direct consumer payment exceed the network revenues generated by advertiser support, then this would permit the pay-cable network to offer greater compensation to the program producer and the program would migrate from "free television" to pay television. In simpler terms, if the consumer household values the program more than the advertiser values its exposure to the household, then pay TV can entice/siphon programming or networks from "free" television to pay television.

The situation is slightly different for the advertiser supported cable channels. Here the consumer payment is less direct since these networks are unavailable a la carte but must be purchased as part of a "basic" cable package for a monthly subscription fee. This is a similar situation to a newspaper which is truly a bundle of different news and information items that are sold as a package, even though the consumer may not wish to purchase every single item. Another difference from the premium channels mentioned above is that these "basic" networks sell advertising as a second source of revenues. In this sense these program networks are hybrids, lying in between the extremes of total advertising support (e.g., CBS, NBC) and total consumer support (e.g., HBO,

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[3] This example is for illustrative purposes only; networks like HBO group individual programs and sell the entire package for a single monthly fee.

Showtime). Such hybrid networks are not as reliant on ratings as the commercial TV networks since they get their per household subscription fee regardless of audience size. Yet, their national advertising price per time unit does directly depend on audience size, and without sufficiently attractive ratings, the local cable system may terminate them in favor of a different network which promises to deliver the marginal subscriber. To put this in equation form, the revenues accruing to the individual program (or entire basic network) consist of the sum of the per household subscriber fee times the number of national subscribers plus the cost per thousand to advertisers times the number of expected households times the number of 30 second spots in the half hour time period.

Revenues per program = per household subscription fee x no. of subscribers + cost per thousand x number of expected households x number of spots per time period.

Programs or networks can be expected to migrate to "basic cable" when this stream of revenues exceeds that accruing to commercial network distribution. Once again, programs or networks will migrate toward the highest revenue generating service. Only if advertisers express a willingness to pay progressively higher prices per household and networks can stabilize or increase their absolute audience size will this gradual migration to cable be stopped. Eventually, the loss of individual program types might turn into the migration of entire networks or partial networks covering significant portions of broadcast day. For example, the networks might set up a hybrid cable channel featuring only daytime soaps and quiz shows or prime-time programs or else add these desirable program types together to form a full-fledged network. This would most likely occur when cable penetration has reached the 70-75% threshold (by the year 2000).

Question #5--Will local news be the next service to migrate to cable?
Question #6--If not, how will this affect local television stations?

As noted in the migration scenario of question 4, the commercial TV networks can be expected to migrate to cable at some point in the next decade unless events drastically change. The inevitable consequence of such a move would most affect local network affiliates since the quality of their network schedule would be relegated to third-run programming, if the networks continued to provide a supplemental over-the-air broadcast service. Local affiliates currently broadcast network programs for nearly two-thirds of their broadcast day. This would leave an enormous void and severely diminish the capitalized value of an affiliation contract and hence the economic value of these stations and perhaps all broadcast stations. Some stations may not survive such a shock! Power would definitely shift in favor of the local cable system, and the remaining broadcasters would essentially become programmers for the local cable system. They probably would continue broadcasting in an attempt to serve the uncabled universe of households. Thus, migration of programming or stations can also be expected at the local level as these stations seek to capture the extra revenues associated with direct consumer payment for programming. Since local news is the most desirable source of local programming, economics suggests that it would be an early migrator should local station fortunes start to wane.

Most importantly, in this transformation, the local station will have to do significantly more local programming to survive, especially in terms of news, since one would expect top national syndicators to sell directly to superstations or family oriented cable networks like USA or CBN rather than engage in the added transaction expense of market by market sales. This migration scenario assumes, of course, that local television and cable delivery are complements rather than substitute products. If the local broadcast stations decide to fight cable, they may discover a continued deterioration in their audience levels, advertising prices, revenues and profits as fractionalization continues. It seems to me that the lure of direct consumer support via cable will eventually entice local stations to join with the enemy rather than fight it out in the trenches.

To guarantee diversity in the local marketplace of news and information, some sort of revised "must-carry" rules in conjunction with relaxation of the (free) compulsory license provisions seems inevitable. Alternatively, some sort of guaranteed leased access or improved A/B switches may be necessary for local broadcast stations. Otherwise, the cable system would be in a dictatorial position in choosing which source(s) of broadcast news reach the vast majority of the local audience.

Question #7--Radio programming is often talked about as the most local medium, but what about the growth of automated programming from national networks?

With the arrival of television and its supremacy as a national broadcast medium, radio was forced to reevaluate its strategic position in the new broadcast world. Its response was to seek a new product niche by differentiating itself from television through the use of specialized programming formulas or what soon became known as "formats." Each format (e.g., country and western, rock, all news, etc.) would be narrowcast in the sense of appealing to a small target demographic profile of listeners, selling advertising time to local businesses interested in their target audience, and relying upon networked programs only for national news and occasionally for sports. To the extent that the radio station also provided local news (prior to deregulation in 1981) and had live disk jockeys, announcers or talk show hosts, its claim to being a local medium was reinforced, even if it was a part of a nationwide chain of broadcasting and other media properties.

Yet, it should be understood that for stations that relied on music, the programming was essentially national in origin and was distributed by large national record distributors (or independents); few of the records were locally produced. Hence, like TV stations which use national network programming or national syndicated programming and only a small amount of local news and entertainment shows, the local radio station is really an outlet for nationally produced content. In a similar fashion, the so called "local" newspaper relies for a significant amount of its newshole on national sources of news supplied by wire services and other syndicated sources (e.g., for editorials, certain columns, horoscopes, comics, etc.)

The reason for the national sources of programming for these supposedly local media rests upon the "public goods" nature of programming which means that like national defense, police protection and similar products supplied by governments, one person's consumption of the media product does not exhaust its utility—an equal amount of utility is available for everyone to consume. Hence, when I consume "The Bill Cosby Show," "Star Trek V," Ann Landers, Doonesbury, or the latest Michael Jackson album, it is still available for others to consume in like quantities.

On the cost side, there is an enormous "first-copy" cost involved in creating the program, movie, comic or album; however, once created, the cost of distributing the product to the marginal person (its marginal cost) is small, and the average fixed "creation" costs decline with increased circulation/audience. Such declining costs are indicative of scale economies in production/distribution. They foretell the emergence of "networks" where high quality/high cost programs/content can be shared at enormous cost savings compared to where every newspaper, broadcast outlet or theater produces its own programming solely for its own audiences. Therefore, one should not be surprised that radio stations will wish to be associated with national distributors of music and news product.

The interesting twist in the radio business is the emergence of a new intermediary between the record distributor and local radio station, namely, the consultant. The consultant, specialized in a certain format, will be hired to make program decisions in one of two ways; either by providing a list of top hit records and records "on the rise" which should be played a prescribed number of times per day or in a certain order _or_, more pervasively, automating the program schedule for the radio station by physically providing the music in a "ready to go" format (with or without the possibility of inserting local news and weather reports). The more formal is the role of the consultant, the more his/her service resembles that of the former radio network, and the radio station thus acts like an affiliate.

Such a system can be rationalized as relieving the station from the need to maintain a full-time program director and permitting the station to tap into greater musical expertise (the consultant) than is available at the local station. On the other hand, there will be the ominous danger of homogenization of program content since only a small group of consultants serve as gatekeepers—determining what records will be heard and what won't. In a sense, we have the creation of a strategic bottleneck if use of consultants and pre-packaged music become widespread.

I seriously doubt whether radio could ever become a truly local medium because of the economic incentive for common use of programming, whether physically networked or suggested by consultants. It is for similar reasons that local television stations never truly were local in their orientation.

Senator INOUYE. Thank you very much.

Senator McCain very eloquently described the situation that more residences have TV sets than indoor plumbing or telephones. When you add to that the recent statistics showing that students spend less than an hour per day doing homework but about five hours watching the tube, we are dealing with something that is profoundly powerful.

Now we do not have the answers. We have been, as Professor Litman alluded, barraged with suggestions that big is good if we are dealing with the international market, and you have to be big to deal with the big combines in Japan and Germany and elsewhere.

First, will you submit to us, Professor Bagdikian, the names of those organizations that control, let us say, one-third of the viewership? You gave us numbers.

Mr. BAGDIKIAN. They are the three networks. They still have somewhere between 67 and 70 percent of the television market, and they still have in their television operations about a third of the revenues, part of which they share with affiliates. But they control still about a third.

And then after that—I am combining radio and television in terms of revenue—then the number of firms that follow have a rapidly diminishing share of the market. So the market domination, it seems to me, is pretty clear.

Senator INOUYE. And all of you agree that domination of the market or concentrated ownership is per se bad and is against our national interest?

Mr. LITMAN. I certainly do agree that an extreme amount of concentration is antithetical to some of the precepts of the Constitution, especially those which talk about diverse marketplaces of ideas, and that the correct conclusions are being drawn from competition in those marketplaces, yes.

Mr. **Salinger**. I think that concentration in any well defined market is generally undesirable unless it is necessitated by scale economies. I am less concerned about national concentration numbers when markets are local rather than national. I do not see any problem necessarily with joint ownership of newspapers across different localities.

Senator **Inouye**. Do you also believe that?

Mr. **Bagdikian**. I think that concentration in any industry that establishes sufficient control over prices and product and protects itself excessively from competition from new entries is bad. But I think that in the media industry it is particularly bad because that represents the terms of our national discourse. Through entertainment, we establish social norms for whole generations. And it represents enormous political power.

So I think that concentration in the media is a particularly serious problem, and I do not agree that big is better. And while obviously there are some economies of scale that permit viability I think we are way beyond the need for viability in terms of our mass media.

I think one measure is that as we have seen increased concentration, we have also seen increased profit levels. While it is not always given to all of us to have access to the profit margins of individual newspapers as opposed to their parent firms, those who do have access to these data tell us that of American daily newspapers, on the whole, pre-tax annual profits range between 20 and 40 percent, and in affiliated TV stations higher than that.

Quite aside from the economic power, it means dominant access to the audience. In the case of newspapers, of all cities that have a daily paper, 98 percent have monopoly managements. We have newspaper chains that are collecting local monopolies.

And in broadcasting the three affiliated TV stations still have a majority of access to the public and a majority of the revenues. And in the book business, magazine business, concentration is going on at very high rates and those are translated into real levels of profit and real levels of market power.

It becomes harder and harder for the new independent magazine that is not carried along by one of the large firms to get space in news stands and for a book publisher to get space in the book chains. So it is a self-feeding process, and I think we have gone far beyond the point in which we are dealing with economic survivability.

Senator **Inouye**. Many men and women of great power and influence have suggested that the media market is an international market. Do you agree with that, or do you believe that it is still a distinctly U.S. market?

Mr. **Litman**. And, of course, from an antitrust standpoint the definition of a relevant market is a critical consideration.

I believe there are international aspects to this industry as there are international aspects to the auto industry and steel industry. But I believe that it is sufficient to examine the U.S. market as a large enough combination of local markets to get meaningful evidence and to make reasoned judgments.

Yes, there is a lot of play both going out and coming in of news, information and entertainment. One thing that I think needs to be stressed is that in this news-entertainment-flow of information industry the United States has been overwhelmingly predominant. This is not the case where we see the automobile industry being dominated by the Japanese or when some of the consumer electronics industries were at a competitive disadvantage. For example, the fear of the HDTV people is that Japan is going to dominate.

Going all the way back to the development of the motion picture at the turn of the century, the United States has dominated the world market for information, motion pictures, and entertainment. So I do not have any fear that we are going to lose that type of control.

The fact that the other countries have placed various types of content restraints on our entry into their markets and the coining of the term "media imperialism 'suggest that the United States has had, and I suspect will continue to have, a domination in this world market.

The thing that is different here is now we are seeing foreign ownership, and that is a totally unique situation—other companies coming in and trying to run our own cultural institutions and entertainment and news organizations. And that is a concern that should be equally as important to us as if they were coming in and trying to control our auto industries and steel industries.

Senator **Inouye**. Should we extend the rules limiting foreign ownership?

Mr. **Litman**. I think that that is a concern that needs to be examined. I would be in favor of looking very closely at that, and if there is this continuing problem with the domination by these foreign owners I would seriously consider looking at that and advocating restrictions, yes.

Mr. **Salinger**. If you are going to address the question of whether these are national or international markets I think you have to distinguish among the different stages of the industry. If you want to ask whether or not the production of movies is a national or international market, I think that is probably an international market.

On the other hand, if you want to ask whether or not cable system operation is an international, national or local market, that is in some ways a local market. If I am dissatisfied with my cable operator, I am not going to substitute the cable operating services of a foreign producer. It could be viewed as a national market if system operators continually competed against each other for franchises and franchise renewals. But the 1984 Cable Act along with the FCC's interpretation of effective competition have effectively made the markets local.

Mr. **Bagdikian**. I think there is no question that the media market is international and it will become more international with the passage of time, both because of technology like satellites and because of growing affluence in many countries of the world. So I think it is a real problem and it is not going to go away.

What we do about foreign ownership of American media, I think, depends on what we do by way of domestic control of concentration of all media companies, not just foreign ones. At the present I think the American balance of trade in media is highly favorable.

Our programming on television and movies and some other media are very active in foreign markets.

It will become even more active in 1992 when the Common Market becomes a single market, when they expect that, for example, they will need 500,000 hours of TV programming a year, most from the United States. Some of the new satellites going up over Europe, the TV channels have simultaneous audio channels for different languages. I think that is the kind of thing we are going to see around the world.

I think there is a fear of retaliation if we try to limit foreign ownership in some ways that are seen as unfair and highly discriminatory, given the activity of our own companies abroad.

So it seems to me that we could do what some foreign countries do. The German Federal Cartel Office is relatively tough and limits some of its own companies in percentage of market—although they are a national market, unlike our newspaper market, so that they have quite different patterns.

But it seems to me that if we established antitrust limits on concentrated ownership for the media within the United States and applied it equally to foreign and domestic firms, we would at least diminish retaliation against American products, and it would be a fair policy. I think it would be healthy internally.

The alternative, it seems to me, is that we give up the idea of diversity, because if you go on a free market principle, the biggest firms are the ones that are going to be dominant globally. That is a rather unhappy picture, in my view, but I think that is what is going to happen, left to its own devices.

So that if the excuse is given that American firms must be unlimited in their market power in order to compete with foreign firms, that argument will prevail, if that is the only thing taken into account. But if we take into account the domestic health of the United States in terms of choice and diversity in the media, then there has to be some kind of intervention on the size of media firms, foreign and domestic.

Senator INOUYE. The recent dissemination of news by the Chinese central network, as contrasted to our networks, I think dramatically demonstrated the importance of the free flow of information. Do you believe that the high concentration of ownership enhances the free flow of information or the dissemination of news or restricts it?

Mr. LITMAN. Senator, I am really not an expert on the international free flow of news and I would like to defer to my colleagues on that.

Senator INOUYE. I mean free flow in the United States.

Mr. LITMAN. OK. In the United States I think that when you have national ownership, to the extent that we see this chain ownership across these different media, that it does have an influence as to what will be published or what will be broadcast, that the flow of information within an organization comes from the top down, just as it does horizontally from the national broadcast facility in New York throughout the rest of the country.

In other words, people will get signals within an organization as to what is acceptable type of programming and what is not acceptable, what the charismatic leader of an organization believes is an important set of agendae and what is not.

In other words, I think the false impression is given that somehow these organizations run themselves and that there is no direction from above. And I think that is the subtle danger that we do not see when we only focus in on numbers. There is a qualitative aspect to this media concentration and the impact on diversity that is often too subtle to be measured but nonetheless is there.

Mr. **Salinger**. I do not think that recent trends in overall media concentration are disturbing. One could imagine a case where there was exactly one company providing all of our television and newspaper and periodical news. That clearly would be undesirable.

On the other hand, one could imagine a world in which there were a series of little local newspapers, where probably none of them would be big enough to have much of an incentive to send people to China to report on what was going on.

I think in the current situation there are enough different voices that we have good access to news.

Mr. **Bagdikian**. Senator, I have spent most of my adult life in the news media business, on the reporting side when I have not been trying to look at the pattern of media generally. And I think there is a high degree of protection against crude and absolute censorship by corporate ownership.

I believe with equal conviction that there are differences because of corporate ownership. It is not a difference of absolute censorship because I think our professional standards and our public sophistication are too great. There are alternative sources of information, although most of our people get most of their information from a few central sources.

But news that could damage the corporate value of the parent firm clearly have a more difficult time getting on the air, getting on page one, being treated in length, being treated in daily pursuit, more so than news not affecting the corporate fortunes of the media company.

I think it is quite clear that on ownership issues of the media, the media are almost silent in its news reporting. As we have seen when newspapers were not in the broadcasting business they thought that it was ridiculous to claim First Amendment rights for broadcasting, which is a protected monopoly. They were all for the Fairness Doctrine and equal time. But when they were heavily in the broadcasting business, they switched positions.

And I think there are small evidences that it makes a difference. Last year General Electric, for example, sold its domestic appliance business to a French company, a big but routine transaction. What that meant was getting rid of its advertising symbol of decades—of GE, the friendly company that brings you better living in your home. And it was a loss in that respect. That rather large sale was reported on ABC and CBS that night, but it was not reported on NBC, which is owned by General Electric. That could have been accidental, but maybe not.

It is not a case of absolute and crude censorship, but absence of information when it is sensitive to the corporate good of the the parent firm. One reason why I am concerned with foreign domination of our telecommunications system, is that it will tend to screen out those things that are offensive to the parent firm.

Several years ago the American Society of Newspaper Editors polled its members and compared the responses from members of chains and members of independent papers on whether they would feel free to print news that was damaging to their parent firm. Thirty-three percent responded that they would not feel free to print news damaging to their parent firm. I find that highly disturbing.

I have been a news person all my life and do not believe that most of the people in that business are corrupt. I think they simply learn that some things are not worth the trouble to get into the paper.

Mr. LITMAN. May I add one little aspect? Those of us who I guess would be called alarmists, who point to the problems with increasing concentration, often are labeled as wanting to return the United States to some sort of society that was prevalent at the turn of the century where you had the small shop owner and the small mom and pop telephone system and what would be considered today a small mom and pop cable system.

I think that is a distortion as well. No one is arguing that we need to return to that small of an entity. I am confident that my colleagues on the panel would not argue that some chain ownership, whether it is chain ownership of drug stores, grocery stores, newspapers, broadcasting stations, cable systems, that some chain ownership is valuable.

It does increase efficiencies and does make companies more competitive. The question is between simply being large, taking full advantage of economies of scale, and being a giant. And it is where that critical threshold is crossed that we switch away from efficiencies into market power and market dominance, and that is where the issue of how large is large and what is the difference between a large firm and a mega-giant firm where the issue of antitrust should come in.

Senator INOUYE. Is it possible to set this threshold that you speak of mathematically or scientifically?

Mr. LITMAN. I suppose if we were—this gets to the issue of micromanagement of industries. I suppose we could assess each industry, find out how large companies needed to be in order to take full advantage of all efficiencies, and you could have a different type of policy for each industry.

I think the antitrust laws, through the precedential history of various cases, have set general limits. I do not believe that you can, in every single instance, set a specific standard that should govern all industries.

I think we need to apply more of a rule of reason and I think that is the reason why the antitrust laws, especially in merger proceedings and monopolization cases, do look at the surrounding circumstances of the industry.

I would not be uncomfortable with a maximum of 25 percent control for the multiple system operators, and I think that would be reasonably consistent with what is being done on the broadcast side.

Senator INOUYE. Senator McCain.

Senator McCain. Thank you, Mr. Chairman.

Would any of the three of you, if you had the authority, agree to the Time-Warner merger?

Mr. Litman. No, I would not.

Senator McCain. Professor Salinger?

Mr. Salinger. I think it is possible to object to some parts of that merger without objecting to the whole thing.

Senator McCain. Well, let me say: as it is presently structured, would you agree to the merger?

Mr. Salinger. I would consider making divestiture of some of the cable systems a condition for the merger.

Senator McCain. Professor?

Mr. Bagdikian. I would not approve of it.

Senator McCain. Professor Bagdikian, in your statement you say that cable ought to be reregulated and then you say, "Some rule is needed to keep systems open and responsive to subscribers, a great majority of whom are stuck with a local monopoly."

What kind of rule would that be?

Mr. Bagdikian. Well, one thing that could happen—I am not sure of all the alternatives but it could go back to the way it used to be in which the municipality, in almost every case where there is a monopoly system, would be vulnerable to voter reaction if they did not implement the franchise with the cable company at renewal time for failure to provide good service or charging, unreasonable rate increases.

Today there is almost no way to adjudicate those things. Cable rates have been going up something like double the cost of living, and while a previous witness has said that their customers are happy, that is not what the newspapers report in many places.

Senator McCain. That is not what my mail reports either.

Mr. Bagdikian. And there is almost nothing the subscriber can do because they are dealing with a monopoly company-except to stop the service.

Senator McCain. So you feel that one way would be that rules of licensing would be at renewal time up for some kind of voter decision, or are you talking about through their elected representatives as the community elected leadership?

Mr. Bagdikian. Well, I have not really thought about the alternatives. It could be that. It could be like the old-fashioned broadcast licenses, which in fact could be challenged at one time in a practical way, which used to come up every three years. And if community groups were unhappy with the service they could challenge the license on the basis of the history of that service, and the FCC would have to make the decision.

Or it could be returning power to the local municipality to make a contract and then be in a position to change it.

Senator McCain. Could it be also to allow other companies to compete, recognizing that there is an enormous expense in laying new cable, although also recognizing that we are now in a position where perhaps we could transmit that signal in other ways?

Mr. Bagdikian. Yes, and I think that is what initially happened. Cable companies had to bid for the municipal contract and they offered all kinds of——

Senator McCain. But I mean when they are up for renegotiation.

Mr. **Bagdikian**. Well for those companies that have put in capital investment, in all equity some recognition would have to be given for that. If someone has wired most of a community at its own cost, it could not have the license taken away without some just compensation.

But I think there ought to be some way to hold real power over a monopoly company that is not satisfying its customers and that has almost total control as to product and as to price.

Senator **McCain**. And there are basically two ways of doing that. One is through rulemaking and the other is through allowing competition, there being some overlap between the two, right?

Mr. **Bagdikian**. Yes, and I would, just on principle, prefer competition in which the regulatory agency has the responsibility for making sure there is genuine competition.

Senator **McCain**. Thank you.

Professor Salinger and Professor Bagdikian, Professor Litman in his final sentence in his statement says, "Unless a line is drawn the spiral of increasing concentration and control, homogenization of content, and rising prices will continue unabated." Do you agree with that?

Mr. **Bagdikian**. I do. I think if you look at our newspapers today they are increasingly similar for their national and international news and in all things other than strictly local news. If you look at through-the-air broadcasting, the three networks are almost indistinguishable in their programming. Cable companies are almost indistinguishable in their basic services or programming.

And I think there is no question about it. I agree wholeheartedly with that.

Senator **McCain**. Professor Salinger.

Mr. **Salinger**. I do not know what line needs to be drawn.

Senator **McCain**. That was my next question.

Mr. **Salinger**. Well, I do not think I can answer affirmatively to the first one without knowing what the answer to the second one is.

Senator **McCain**. Perhaps I can switch to Professor Litman, who would describe what that line is. I understand, Mr. Chairman, we have a vote so if you would make it as brief as possible. I know that is difficult, Professor Litman.

Mr. **Litman**. I am not prepared to go chapter and verse on where the line is, but I think there is a general line that needs to be drawn basically saying that we have antitrust laws on the books.

If I remember correctly, in 1950, when the amendment to the Clayton Act was passed, the Celler-Kefauver amendment, that was in a similar period of rising concentration and the intent was to prevent further increases in concentration before you got to the point where you had to start talking about breaking up these companies.

An ounce of prevention is worth a pound of cure, and I think in general terms I would say let us go back and enforce the antitrust laws and basically give a signal, policymakers give a signal, that this is just not acceptable behavior.

Senator **McCain**. The first step you would take would be to reject the Time-Warner merger?

Mr. LITMAN. I think that there are certain aspects of that merger that are anticompetitive, especially in the MSO cable system ownership, and that is an increasing problem that will further exacerbate the problems of new program services gaining access and the problem with new technologies gaining that programming as well.

For those reasons I would be opposed to it.

Senator MCCAIN. Well, I thank you all for helping me to understand an incredibly complex issue and I think not only for me but for the record you have provided us great service today. I thank you.

Thank you, Mr. Chairman.

Senator INOUYE. I thank you very much, gentlemen. In behalf of the Committee I thank you. It is a complex problem and, if you do not mind, we will be calling upon you time and again to assist us as we proceed in this very difficult trail for the truth. So thank you.

The hearing is recessed until next week.

[Whereupon, at 12:12 p.m. the subcommittee adjourned.]

MEDIA OWNERSHIP: DIVERSITY AND CONCENTRATION

WEDNESDAY, JUNE 21, 1989

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, DC.

The subcommittee met at 9:03 a.m. in room SR-253, Rayburn Senate Office Building, Hon. Daniel K. Inouye (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR INOUYE

Senator INOUYE. This morning, the subcommittee holds the second hearing on media ownership: diversity and concentration.

This hearing will focus on ownership issues in the cable television industry. Some of these issues were touched upon at last week's hearing. The purpose of this hearing is to bring together the various issues and explore them in length.

Over the past four years, there have been concerns about integration and concentration in the cable television industry. The subcommittee already has some familiarity with the issue of vertical integration. For the past two Congresses, the subcommittee has considered Senator Gore's legislation to ensure that satellite dish owners have access to cable programming.

Now we hear claims from other video distributors that they also want access to this programming. We have also heard concerns about vertical integration from programmers unaffiliated with cable operators. They believe they face unfair obstacles in having their programs carried on cable television.

As for horizontal integration, there are questions about concentration in the cable industry at both the local and national level: Does a cable operator have a local monopoly? How many subscribers should a cable operator be able to reach across the Nation? Should cable operators be able to own other means of distributing video programs?

All of these questions have a common foundation and should be examined together.

We are fortunate to have excellent witnesses to help us in our inquiry. On the first panel are witnesses from the cable television industry. They will be followed by those parties who have concern about the market power of the cable industry. And I look forward to hearing from these distinguished witnesses, and welcome them here today.

And before I call upon these witnesses, I am pleased to call upon Senator Gore.

OPENING STATEMENT BY SENATOR GORE

Senator GORE. Thank you very much, Mr. Chairman. I want to thank you for holding this important series of hearings.

The larger issue of media diversity is one which concerns every member of this committee, and the entire Congress for that matter.

And the issues that underlie the current threats to continued media diversity have never been more important or deserving of careful attention. I am sorry I was unable to attend the first in this series last week. I have been involved and active in these issues for more than 12 years, as a member, first, of the House Telecommunication Subcommittee, and now this Subcommittee.

I am especially pleased that today's hearing will focus specifically on cable television policies. Last month I joined with my colleagues, Senator Gorton and Senator Ford, to introduce the Cable Competition Act, legislation designed to address the serious problems facing cable television consumers. The point of this bill is to give cable consumers modest relief from skyrocketing rates and the pervasive anti-competitive practices within the cable programming industry.

Precipitous rate hikes of 100 percent or more in one year have not been unusual since cable was given total freedom to charge whatever the market will bear. To illustrate only a single case, a new multi-system operator purchased a chain of small franchises in rural west Tennessee using highly-leveraged capital and paying inordinately high sums for small systems with already high penetration and little room for growth.

The company immediately raised basic rates by 50 to 100 percent with absolutely no increases in the quality of the service. Clearly, this was a way to cover the huge cash flow needs created by such franchise trafficking and speculation with captive consumers.

Not coincidentally, these franchises are well outside the range of clear, over-the-air signal from metropolitan, magnifying the captive nature of cable consumers in the rural systems.

I am pleased to report this very morning that that company on the eve of this hearing, within 24 hours of the hearing, and within a few weeks of the introduction of our bill, has suddenly and perhaps coincidentally decided to roll back these outrageous rate increases. That is a step in the right direction.

Mr. Chairman, the thousands of mostly rural, captive cable customers in west Tennessee welcome the Multivision rollback. Clearly, it was about time that this company rethought one of the most arrogant business decisions I have ever encountered.

But, Mr. Chairman, this belated action, after almost a full year of intransigence by the cable operator, really does not solve the underlying problem. No business in America should be in a position where it faces neither competition nor regulation.

Since cable was deregulated, we have witnessed an extraordinary concentration of control and integration by cable operators and program services manifesting itself in blatantly anti-competitive behavior toward those who would compete with existing cable operators for the right to distribute services.

In the case of satellite dish owners, to which you referred in your opening statement, Mr. Chairman, program services have consistently refused to deal with distributors unless they meet one key test: they have to be cable system owners. And that shuts out almost all competition for a market that ironically cable itself has largely refused to serve. It is the same arrogance all over again.

I am especially looking forward to the testimony today of our witness from the National Rural Telecommunications Cooperative. When the NRTC was finally able to obtain distribution rights to some programming last year, it was widely hailed as a breakthrough, a reason to drop any legislative effort.

Mr. Chairman, I think we may hear a different story today from NRTC. Clearly, they and the millions of rural customers that they represent are still getting a bum deal.

Now, of course, not all cable operators have exploited their position after deregulation, with total disregard for the public, and not all program services have discriminated against distributors competing with cable. However, the practices have become so widespread and egregious in certain sectors of this industry that the time has clearly come for the Congress to begin serious debate about the problems created by cable deregulation.

Moreover, some of these highly-leveraged takeovers demonstrate that the fast-buck artists are becoming more numerous in the industry. They simply cannot resist a situation where the customers are sitting ducks, there is no competition and no protection from any governmental entity.

The bill to which I referred to earlier is designed to correct some of the inequities now facing cable customers, especially those with little choice. It allows cable franchising authorities to regulate lifeline or basic service where there is no competition.

Under some circumstances it allows telephone companies to provide cable services, with protections against cross-subsidy from regulated telephone customers, while not affecting any restrictions currently in place under the modified final judgment.

The bill requires that cable operators, including common carriers, must provide access to the system for all program services, unless precluded from doing so by channel capacity or the nature of the program content.

It requires programming services which are affiliated with cable operations to make those services available to all distributors of programming on a non-discriminatory basis to foster competition and choice for consumers who are mostly underserved by cable.

The bill requires the Federal Trade Commission to undertake an investigation into concentration within the cable programming industry to determine the degree to which such concentration has resulted in higher rates for consumers and/or unfair treatment of cable competitors.

Finally, the bill requires the FCC to determine ways to improve the availability of video services in rural areas.

Mr. Chairman, this bill is not a scheme to bash cable. This industry has a wonderful product and has made a major, positive contribution to entertainment and information in this country. Many cable operators and programmers are working hard to provide quality services at reasonable rates. And the industry's support for C-SPAN, for example, is to be greatly commended.

I am a strong supporter of cable television. However, too many cable operations are simply aggressive MSOs who are speculating in franchise takeovers, driving rates through the ceiling and providing poor service. And the local franchising authorities are forced by the Federal Government to sit with their hands tied. And too many programmers continue to completely deny access to distributors who might compete with the very cable companies in which those programmers have a financial interest.

It just is not fair. It is time the Congress revisited the Cable Act of 1984 to begin a debate which addresses the problems facing 45 million captive customers of cable television service and millions of other families who cannot even receive cable.

The bill I referred to is designed to do just that. And I hope that this hearing will go a long way toward building a case for its passage.

Mr. Chairman, I appreciate your indulgence in allowing me to make a longer-than-normal opening statement. I appreciate your courtesy, and I look forward to the hearing.

I might note that the Armed Services Committee is addressing the important issue of ICBM modernization, so I will be absent for a portion of today's proceedings. It should not be interpreted as any lack of intense interest.

Thank you, Mr. Chairman.

Senator **Inouye**. Senator McCain.

OPENING STATEMENT BY SENATOR McCAIN

Senator **McCain**. Thank you, Mr. Chairman. I would like to thank you for holding this series of hearings. I think today's hearing is very important, as was the last one, and tomorrow's will be as well.

Mr. Chairman, we are aware that cable has seen a phenomenal growth over the last 10 years. It is my understanding that about 50 percent of American homes now have cable. It has moved from a mere retransmission medium to a valuable programming and information outlet in its own right.

The consumer can now receive countless choices of programming in an infinite variety. Many questions remain about what is happening in this rapidly evolving technological evolution: Will the American public enjoy the fruits of a very successful competitor, or will we only get the spoils of a new bully on the block? Are we witnessing the demise of broadcast television as we know it and moving towards the information have and have-nots?

With cable's growth, obviously there has been some very significant growing pains. Rates have increased significantly. There are allegations, such as those just described by my colleague from Tennessee, who has been very involved in this issue for a long time, of monopoly power and anti-competitive conduct.

There is growing concern that cable is getting or has already gotten too big, and that we have drawn the lines in the wrong places.

These questions and others, Mr. Chairman, I hope and believe will be answered in this very important set of hearings that we have.

I think the American people, who more and more are consumers of cable television, deserve answers to these questions. And I hope that we can provide them with these hearings and legislation, if any is required, to make sure that all have equal access at the lowest possible price to the consumer.

Thank you, Mr. Chairman.

Senator INOUYE. Thank you, sir.

Senator Gorton.

Senator GORTON. Mr. Chairman, I have no opening statement. I am anxious to hear as many of the witnesses as I can. I have the same caveat and challenge which the Senator from Tennessee has and which Mr. McCain has as well, and has stated, on an important conflict today. But I am delighted that we are holding these hearings on a vitally important subject and I look forward to the testimony.

Senator INOUYE. Thank you.

And with that, I am pleased to call upon the first panel: the President of the National Cable Television Association, Mr. Jim Mooney; the President of the Black Entertainment Television, Mr. Robert L. Johnson; and the Chairman and Chief Executive Officer of the Discovery Channel, Mr. John Hendricks.

Gentlemen, it is my pleasure to welcome you to this hearing. And may I first call upon the President of the National Cable Television Association, Mr. James Mooney.

STATEMENT OF JAMES MOONEY, PRESIDENT, NATIONAL CABLE TELEVISION ASSOCIATION

Mr. MOONEY. Thank you, Mr. Chairman.

I have an extensive prepared statement, which we have submitted for the record.

Senator INOUYE. Without objection, the statements of all of you will be made part of the record in total, and you may proceed as you wish, sir.

Mr. MOONEY. Thank you, sir. I will just take a few minutes now to summarize my main points, of which there are three.

First, there is enormously greater diversity in the television marketplace today than was the case even 10 years ago. In 1979, television meant ABC, NBC and CBS and not much else. The three broadcast nets, between them, had a 98-percent share of the viewing audience. The remaining 2 percent was split amongst independent broadcasters, public broadcasters, and the then still nascent phenomenon of cable television. Most people, moreover, had never even heard of a VCR. And today, of course, all that has changed.

The number of independent broadcasters has more than tripled. And the indies now boast that their viewing share is up to 20 percent in prime time.

VCRs are now to be found in two-thirds of television households. And bringing home a movie from the video cassette rental store is now an everyday experience in American life.

And, of course, today there also is cable, which now is available to 86 percent of U.S. television households, and actually is subscribed to by slightly more than half of them.

We attribute our own success directly to the fact that cable is not just more television, it is different. It is specialty television aimed at the diverse interests and needs of our subscribers. And it has to be or else people would not pay for the service when they can already get so much television free off air.

Now, one way to look at this, of course, is to focus on he effect this reordering of the television world has had on the broadcast networks. Whereas the broadcast nets had 98 percent of all viewing in 1979, today their share, even in primetime, has fallen to 65 percent; and that the nets have suffered a terrific jolt to their business position is undeniable.

Another way to look at it, however, is that the emergence of new media has enormously expanded the ways in which our society uses television, and enormously expanded the satisfaction individuals get from it.

If you are interested in public affairs, you can watch C-SPAN or CNN. If you like documentaries you can watch Discovery. If it is the arts that stirs you, you can watch Bravo or A&E; and so forth and so on.

And aside from the broadcast nets' business interest, I think the emergence of the new media, especially cable, has been socially beneficial.

But there is still a third way to look at today's situation, and it is this. The broadcast nets have lost about a third of their primetime audience, but they have still got 65 percent. And as Mr. Dooley might have said, "that ain't beans."

The broadcast nets still hold a commanding position in primetime television and are extremely effective competitors. In fact, I think it fair to say that the three principal obstacles to cable increasing the proportion of households which actually subscribe to our service are named ABC, NBC and CBS.

The second major point I want to make has to do with industry structure. We hear a great deal these days about vertical integration in the cable industry, and in a few minutes, Mr. Hendricks and Mr. Johnson will give you their own view of why that has occurred and how it is working.

I should make the point, however, that vertical integration is not peculiar to cable. It is commonplace in all of the entertainment industries. Group broadcasters like Cox, Tribune and Viacom own program production and syndication arms. Hollywood studios like Fox, MCA and Paramount own or own options to buy broadcast stations.

The three broadcast networks themselves own major-market television stations, which they program with their own network feeds. And this is to say nothing of what we might call diagonal integration, where ABC/Cap Cities owns ESPN, the cable sports network, and NBC owns both a 50-percent share of a series of regional cable sports networks and has just launched its own cable consumer news channel, CNBC.

It is nothing to say, either, of some of the Hollywood studios' reentry into the theater business. Nor is it to say anything of the cross-ownership interests which exists between many video/media companies and print/publishing companies.

And it is to say nothing, finally, about the entry into U.S. markets by international media combines, of which Mr. Rupert Murdoch's News Corporation is the principal example. Mr. Murdoch, of course, owns the Fox Studio, the Fox broadcast stations and the Fox Network.

Now, I am not going to attempt to explain the various motives which have led to other media industry strategies, but will simply say that in the case of cable programming, the cable-operating companies have been motivated to make a lot of these investments, many of them involving minority equity shares, simply by the absence of anybody else willing to do it.

Certainly, some of the most widely-distributed cable networks, like USA, which is owned by Paramount and Universal, and the CBN Family Channel, are owned by companies with no interest whatsoever in the cable system business. But each of them involve familiar programming formats, such as reruns of programs originally on broadcast television which, while very attractive to many cable subscribers, represent no special departure in terms of moving away from the traditional broadcast model.

The further away you do get from that traditional model, the more scarce are potential investors. Banks will not lend money for programming ventures; it is too risky. You need equity capital to do it. And, put in specific terms, if the cable industry did not put up the money for C-SPAN or BET or Discovery or Nickelodeon, or some of the other cable specialty networks, nobody else would do it.

Even HBO, which Time, Inc., took national in 1975, was at the time disparaged by the traditional television industry as a kind of eccentric plunge with dismal prospects for success.

Vertical integration, then, can be a good thing or a bad thing. It depends on the results. And, in terms of cable television, we think the results up to this point have been very positive.

But third, and this is my last point, there is an absence of real empirical evidence that vertical integration in the cable industry has been harmful. We, of course, have our detractors, and you will hear from some of them later on today, but I know of only one thorough, quantitative analysis of cable vertical integration which has been done to date, and that is the one we commissioned Dr. Benjamin Klein of UCLA to do, the results of which we have just recently received.

Dr. Klein looked at the carriage practices of vertically integrated and non-vertically integrated cable companies and found very little difference between them. Specifically, he found that vertically-integrated MSOs are not using their cable systems so as to exclude competing programming networks.

Dr. Klein also found that other subscription television distribution media, specifically the backyard dish market and the new MMDS, or wireless cable industry, are not being denied access to cable programming.

And if I may add my own comment to Dr. Klein's findings, I believe that if you probe the position of the MMDS, or wireless cable, people you will find that their complaint does not so much involve access to programming as it does a dispute over price.

They have much lower capital and operating costs than cable. They have a 5 percent advantage right off the top because they do not pay franchise fees, for example. And they believe that if they can force the same wholesale price as the cable operator gets, they can both underprice him and still get a higher return on investment.

And the flipside of that, of course, is that the programmer sees the MMDS business as one which offers a greater wholesale margin than cable distribution, while still allowing the MMDS distributor to charge a competitive retail price.

So the argument then is really one between businessmen about who gets to keep the additional margin, the MMDS operator or the programmer. And we respectfully submit that, absent clear and convincing evidence of a cable industry scheme to hamstring the MMDS business, it is not a dispute the government should intervene in.

In any event, I recommend Dr. Klein's study to you. We think it deserves serious attention, not because we commissioned it, but on its own merits, and because it helps to bring the battle of accusations down to a discussion of ascertainable and provable facts.

Mr. Chairman, we appreciate being called to give our views. I will be happy to answer any questions the committee has or provide any additional information you desire.

[The statement and questions and answers follow:]

STATEMENT OF JAMES P. MOONEY, PRESIDENT AND CEO, NATIONAL CABLE TELEVISION ASSN.

Mr. Chairman and members of the Subcommittee, my name is James P. Mooney. I am President and Chief Executive Officer of the National Cable Television Association. NCTA represents approximately 2,700 cable television systems serving more than 80% of the 50 million cable households in the United States, and 56 cable programming networks engaged in creating and packaging a great diversity of cable television programming.

NCTA appreciates the opportunity to appear before you today to discuss ownership patterns in the entertainment industry, in general, and in the cable television industry, in particular.

Allow me to begin by summarizing the major points of my testimony.

- During the past ten years, video distribution and television have changed dramatically from a market dominated by the three major broadcast networks to a highly competitive market.

- Cable television has led the way in providing consumers with an unprecedented array of diverse viewing options.

- Vertical integration, i.e., cable industry investment in new programming, has produced more programming and better quality programming choices for consumers.

- The only thorough, quantitative analysis of cable vertical integration done to date, "The Competitive Consequences of Vertical Integration in the Cable Industry," authored by UCLA economics professor Dr. Benjamin Klein, found that the potential negative consequences of vertical integration have not occurred.

    - Vertically integrated cable companies have not foreclosed the market to unaffiliated cable programming networks.

    - Consumer access to cable programming through competing distribution technologies has not been foreclosed.

- Vertical integration is a common ownership trend throughout the entertainment industry, particularly among Hollywood studios.

- The cable industry is not highly concentrated as measured by the standard economic indices of horizontal concentration.

I. The 1980s: The Decade That Changed Television

As America approached the 1980s, television looked pretty much as it had for the previous 25 years. It was dominated by large, commercial VHF broadcasters, generally affiliated with the three major commercial networks. In 1979, for example, ABC, CBS, and NBC accounted for a 98% share of the television viewing audience. The remaining 2% was split among independent broadcasters, public and educational broadcasters, and cable television. Alternative programming by cable networks was more of an idea than a reality. In 1979, Home Box Office, which in 1975 became the first cable network to be available nationwide via satellite, was carried on only 1,100 cable systems across the country and had only 2.8 million subscribers.

Ten years ago there were 622 VHF broadcasters and 376 UHF broadcasters. Only 105 of these were independent broadcasters. There were also 274 non-commercial broadcasters. At the same time, 4,150 cable television systems were serving 14 million of the 75 million television households.

In 1979, alternative distribution technologies were not yet on stage. Video cassette recorders (VCR's) were toys of the rich. Multi-channel, multi-point distribution systems had not yet been authorized by the FCC. It was illegal to intercept and watch satellite transmissions off of backyard earth stations.

In the ten years between 1979 and 1989, the television entertainment marketplace has been transformed.

- The number of independent television broadcasters more than tripled, to 389, primarily because of FCC policies that promoted the development of UHF broadcasting.

- Cable television completed wiring most of the major metropolitan centers of America so that today there are 9,016 cable systems serving just over 50 million households.

- VCRs became a major means of video distribution, going from 1.1 million in 1979 to nearly 60 million in 1989. VCR penetration grew to 66.2% of TV households, surpassing even the growth of cable during the 1980s.

- Home satellite dishes, legalized by FCC rules and as part of the Cable Communications Policy Act of 1984, proliferated from less than 800,000 at that time to nearly 2.5 million today.

- In less than three years, since the FCC began licensing MMDS systems, 23 systems have come into operation serving about 115,000 subscribers. And another 30 systems have been licensed.

The dramatic growth of these new technologies spawned vigorous competition in the television marketplace, competition that has challenged the dominance of the commercial broadcast networks. Granted, the pie being split has gotten bigger, from just under 75 million television households in 1979 to just over 90 million television households today; but that 98% share that commercial broadcast networks enjoyed ten years ago is now closer to 60%.

All of these trends point to one conclusion: The television marketplace, ruled by three firms as recently as a decade ago, has become highly competitive and consumers are reaping the benefit of that competition by access to unprecedented amounts of diverse programming options. The cable television industry has led the way in creating and packaging new programming choices for consumers, alternatives to the lowest common denominator fare carried by the networks and reruns of old network shows carried by the independent broadcasters.

II. Ownership In The Cable Television Industry

As noted above, there currently are 9,016 cable television systems in the United States, serving approximately 50 million American households. Cable is now available to 86% of American TV households, and is purchased by just under 60% of these homes. Many of the nation's cable systems share common ownership by multiple system operators (MSOs). As these companies have grown in recent years, their size and diversification have attracted significant attention. That attention largely has fallen into two general areas: concern over vertical integration and concern over horizontal concentration. I will discuss each of these areas in turn.

A. Vertical Integration

1. Extent Of Vertical Integration In The Cable Industry

Vertical integration in the cable industry (that is: MSO investment in programming networks) has recently come under substantial scrutiny. Yet more than 40% of all cable networks are not vertically integrated. In those cases where vertical integration has occurred, consumers have benefitted from increased choice and improved quality.

In 1979, there were 21 nationally-delivered cable programming networks. Today, as the following table illustrates, there are 66 such services. Three of the five largest networks (based on subscription counts) -- ESPN, USA Network, and CBN's Family Channel -- have no operator investment. And, these networks have wide distribution. From 1979 to 1989, ESPN grew from 4 million subscribers to 50.6 million, USA from 6 million (in 1980) to 45.2 million subscribers and The CBN Family Channel from 7 million to 44.1 million.

Other popular cable networks, such as The Disney Channel and The Nashville Network also have no cable operator investment. (It is interesting to note that among the most popular national cable networks with no operator ownership, USA and Disney are owned by movie companies (MCA and Paramount, and Disney, respectively) and ESPN is owned by a broadcast network (CapCities/ABC).

The following table provides a statistical picture of ownership of cable programming networks.

CABLE PROGRAMMING NETWORKS:
NUMBER OF NETWORKS WITH OPERATOR OWNERSHIP/EQUITY
AND WITHOUT OPERATOR OWNERSHIP/EQUITY

	Total Number of Networks	Total Number of Networks With Operator Ownership/Equity	Total Number of Networks With No Operators Ownership
National	66 (100%)	36 (54%)	30 (46%)
Regional	35 (100%)	22 (63%)	13 (37%)
TOTAL	101 (100%)	58 (57%)	43 (43%)

As the numbers demonstrate, of the sixty-six nationally-delivered cable programming networks, thirty, or 46%, have no ownership affiliation whatsoever with the operating side of the cable industry. Moreover, thirteen, or 37% of the thirty-five regional programming networks function with no operator ownership involvement.

2. Effects Of Vertical Integration In The Cable Television Industry

Television consumers have benefitted substantially from cable system operator investments in cable programming networks. These benefits have been realized both in terms of greater diversity of programming available to cable customers and better quality programming available to cable customers.

a. Operator Investment In Programming Means More Choice For Cable Customers

It is important to understand that operator investment in programming enables cable to be a more effective competitor in the video marketplace. It has been cable's willingness to invest its revenues in developing new cable programming that has produced a rich and varied menu for American television consumers and transformed the cable industry from a medium principally used to retransmit broadcast signals into one that provides consumers with real programming choices.

For television viewers, cable's vertical integration means:

- o Nickelodeon -- quality programming for children, an audience that commercial broadcasters have all but abandoned.
- o Black Entertainment Television -- the only 24-hour national black entertainment network.
- o C-SPAN and C-SPAN II -- the cable industry-funded public affairs channels that provide unique coverage of the U.S. Congress, as well as a wide range of public policy-related events.
- o Bravo -- a network devoted to award-winning domestic and foreign films and performing arts specials ranging from opera to jazz.

- Turner Network Television (TNT) -- programming devoted to family viewing.
- The Discovery Channel -- an all science and nature documentary channel which was preserved by cable operator investments.
- Cable News Network (CNN) and Headline News -- the pioneering all-news networks that now set the standard for news reporting.

The reason for this investment is the result of several factors. The first major factor is need. Cable must compete against broadcasters and their networks through product differentiation in programming. One way that cable competes most effectively is through targetted programming -- specialty programming, if you will -- aimed at particular interests and needs of different groups among our subscribers. It is somewhat analogous to the market fragmentation approach we have seen over the last several years with magazines in which there now seems to be a periodical for every conceivable interest and topic.

The second major factor behind operator investment is economic necessity. Traditional sources of funding for programming simply are unwilling to take the risk on specialty programming. Without operator investment, the diverse programming choices enjoyed on cable today would not exist. The further away you get from the mass audience approach of broadcasters -- lowest common denominator programming -- the more scarce are potential investors.

Banks will not finance specialty cable networks because they find the risk unacceptable. Traditional sources of programming capital, such as Hollywood studios, also have been uninterested. For example, Warner started MTV and Nickelodeon. When they needed more money to continue to develop these channels, they went to the other motion picture studios with the opportunity to purchase or invest in the networks and were turned down. Eventually they sold the networks, along with Showtime, to Viacom, a major cable MSO willing to take the risk.

The Subcommittee will hear today from Bob Johnson, President of Black Entertainment Television, and John Hendricks, President of the science and education network, The Discovery Channel. Both will recount their fruitless efforts to obtain funding from traditional sources. I will not attempt to tell their stories, but I would like to offer two observations.

First, operator investment in these networks, as in others, has been a matter of capitalization for the network, not acquisition for the operator. The operators are minority investors whose level of equity participation in the networks falls far short of control.

Second, without operator investment, neither Black Entertainment Television or The Discovery Channel would exist.

The same is no less true for other programming networks started or maintained with operator funding, networks like C-SPAN and C-SPAN II, the Weather Channel, CNN and Headline News, VH-I, Home Box Office, Cinemax, The Movie Channel, Mind Extension University, and others.

Without operator investment in programming, the diversity of consumer choice that cable has come to stand for would not exist.

MSO investment in programming is the engine moving cable to fulfill its promise and potential by developing and providing a diversity of programming choices for consumers.

With increasing operator investments in programming, it is no surprise that top basic cable networks are projected to spend $935 million for programming in 1989, up by approximately $190 million, or 26%, from the amount spent in 1988, and almost triple the $340 million spent in 1984, when Congress enacted the Cable Communications Policy Act. This increased spending improves the quality of the choice cable offers -- and thereby provides direct consumer benefit.

b. Operator Investment In Programming Means Better Quality Programming

Attributing improved basic cable programming to the fact that the cable industry "has more money to spend," Business Week noted that "basic cable channels are looking spiffier" and that "these days cable channels are growing into much, much more than retirement homes for yesteryear's hits."

Perhaps the greatest evidence of cable's performance in providing quality has been produced by our principal competition -- the broadcasters. Each year the Television Information Office commissions the Roper Organization to survey America's attitudes toward television. This year was the first time the public was asked to compare cable television with network television. The result was that cable got better marks than network television for sports, cultural, children's and educational programming, and overall quality. The following chart reports some of the poll's findings.

%	Regular TV	Cable TV	Both the Same	Don't Know
Better entertainment programming	26	47	16	11
Better national news coverage	45	33	11	11
Better local news coverage	72	11	7	10
More educational programs	28	47	11	14
More sports programming	17	61	10	13
More cultural programming	22	51	10	16
Better quality programs overall	32	37	16	14
Better programs for children	31	39	11	20
Greater program variety overall	24	52	12	12

This change in public attitude is for good reason. Last year, the TV critics rated the program "Dear America: Letters from Vietnam" as the best program seen on television in 1988. "Dear America" was an original production of Home Box Office.

Last year HBO won two Emmys and this year won two Oscars, all for original productions. And, Home Box Office continues to develop new and original programming of a quality seldom seen on television.

The quality of cable is not merely limited to the pay channels. The quality is all over basic as well. The Arts and Entertainment series tracing U.S.-Soviet relations, "The Eagle and the Bear," was compared favorably by The New York Times to the classic documentary, "Victory At Sea."

Basic service program networks are tackling tough issues of the day in a way that the broadcast networks are not. Lifetime has done a serious examination of the growing childcare crisis in the country. The Learning Channel, in conjunction with the U.S. Conference of Mayors, is exploring our nation's drug tragedy.

Children's programming continues to be a major source of concern to cable and a fertile source of quality programming on cable. Shows like "Ask Mr. Wizard" on Nickelodeon, Jim Henson's "Fraggle Rock" on TNT, and The Disney Channel provide education and entertainment for children that is at least as good -- and often much better -- than anything on broadcast television.

National Geographic specials are first aired on Superstation TBS. The Discovery Channel and The Learning Channel educate and entertain children and adults alike.

The litany of quality programming goes on. After the judgment of consumers, reflected in the Roper poll, perhaps the best indication of our success in providing programming competition to broadcasters comes from the broadcasters themselves. There is a growing movement among broadcasters -- especially independents -- to try to copy popular cable formats. We now see broadcasters offering home shopping channels and music videos, for example. They even compete against cable with cable's own programming. When Fox launched its network with their Sunday night line-up, it featured "It's Garry Shandling's Show," a comedy series which each week shows reruns of episodes that already have appeared on Viacom's Showtime.

Not only have cable operators fostered more and better cable programming by investing directly in programming networks, but they have also increased the amount of money their systems spend to acquire programming. From 1980 to 1988, the amount of money spent by cable systems for programming increased by 842%, from approximately $276 million to approximately $2.60 billion.

Again, this investment benefits cable customers by providing more and better television programming.

c. Empirical Analysis Indicates Potential Anticompetitive Consequences Of Vertical Integration Have Not Occurred

- Market entry for cable programming networks without MSO affiliation has not been foreclosed.

- Access by competing distribution technologies to cable networks with MSO affiliation has not been foreclosed.

(1) Vertical Integration Has Not Foreclosed The Market To Other Programmers

As I have discussed, Mr. Chairman, the cable industry's investment in programming has greatly expanded the diversity of choices available to consumers. This has not, however, excluded from the market cable programmers not affiliated with MSOs.

We believe that the most significant study of this issue done to date is one prepared for NCTA by Dr. Benjamin Klein, professor of economics at UCLA. This study, "The Competitive Consequences of Vertical Integration in the Cable Industry," which we released earlier this month, is attached to my testimony as Appendix A. It may be useful here to highlight the results of his study.

The benefit to consumers of vertical integration, as I have discussed, is readily apparent. However, critics of the cable television industry have frequently raised the spectre of anticompetitive costs associated with vertical integration. I might add, Mr. Chairman, that these critics often are real or would-be competitors who unfailingly raise this spectre through inference and innuendo, but without corroborative evidence.

Dr. Klein devoted the bulk of his study to examining very carefully whether any negative consequences of vertical integration have occurred. His study presents sound statistical analysis of the network carriage patterns of a random sample of 400 cable systems (that serve 33% of all subscribers), focusing on carriage of the top 28 basic and premium cable networks.

In summary Dr. Klein found that vertically integrated MSOs are not using their cable systems as a tool to exclude competing cable programming networks from the market. This finding is supported by the following:

(a) No MSO, whether vertically integrated or not, possesses the economic power to exclude potential competitors from program supply. Even the largest MSO, TCI, cannot by itself prevent the entry of a new programming network.

(b) Vertically integrated MSOs are somewhat more likely to carry their own programming networks, however, this effect is very small (less than 3%) compared to the channel capacity and programming requirements of the average cable system.

(c) Therefore, there is no evidence that vertically integrated MSOs systematically exclude programming networks in which they do not have ownership interests.

(d) In fact, the four largest MSOs with the greatest vertical integration, TCI, ATC, Viacom, and Cablevision Systems, are generally *more* likely than non-vertically integrated cable operators to carry the most popular cable networks in which they do *not* have an ownership interest.

(e) The result is that cable consumers of vertically integrated MSOs have a wider selection of program choice among the most popular cable networks than consumers of non-vertically integrated cable systems.

Dr. Klein concluded:

> "Vertical integration benefits the viewing public by expanding programming availability while posing no current or likely future threat to competition. This implies a Congressional regulatory response to vertical integration in the cable industry is not necessary. Any anti-competitive effects that arise in the future can be handled on a case-by-case basis by active enforcement of existing antitrust laws. Rigid industry-wide rules to regulate vertical integration in the dynamic cable programming marketplace are likely to be harmful to consumers."

Dr. Klein's study is the first extensive quantitative analysis of vertical integration in the cable industry. We commend his analysis to the Committee's attention.

Others have looked at vertical integration in the cable industry and reached similar conclusions.

In June 1988, the National Telecommunications and Information Administration released a study, entitled "Video Program Distribution and Cable Television: Current Policy Issues and Recommendations," which found that cable's vertical integration has produced no adverse consequences. While noting that ownership affiliation does increase the probability that a premium network will be carried by affiliate systems, the analysis concludes that "carriage of affiliated services generally does not occur to the exclusion of unaffiliated services."

The NTIA analysis further tested whether vertically integrated MSOs discriminate against non-affiliated basic services. Although the statistical conclusion reached by NTIA for basic networks is less strong than it is for pay networks, NTIA nevertheless finds that vertically integrated systems are not likely to discriminate against unaffiliated basic services. Based on these analyses, NTIA concludes that: "In sum, common ownership of cable systems and cable programming services does not appear to affect adversely the supply of cable programming or the diversity of viewing choices for cable subscribers."

In another study, much more restricted in scope than Klein's analysis, Michael Salinger, an associate professor at Columbia's Graduate School of Business, conducted a statistical analysis of whether ATC, a cable MSO owned mostly by Time, Inc., is more likely to carry HBO and Cinemax than Showtime or the Movie Channel (both owned by Viacom), and whether Viacom's cable systems are more likely to carry Viacom's networks than Time Inc.'s networks. (Salinger did not examine other pay services or any basic networks.) Salinger concluded that ATC and Viacom are more likely to provide the services they own and less likely to provide the services they do not own.

Salinger's results have been interpreted by some to support the position that vertical integration in the cable television industry is harmful. However, Salinger noted in his study that vertical integration also may provide benefits, such as lower consumer prices, and that whether the effect of vertical integration in the cable industry is harmful or beneficial is not clear. And, as Salinger testified before this Subcommittee June 12, his analysis does not reach a conclusion on this issue.

The logical conclusion of all this analysis, I submit, is that there is no evidence of systematic exclusion of nonaffiliated programming by vertically integrated MSOs.

The available research does suggest that vertically integrated MSOs are somewhat more likely to carry networks in which they have an investment. Klein, NTIA, and Salinger all agree on this point. But, as Klein points out, that must be translated to what it means in practice. (see pp. 35-48 of Appendix A).

Dr. Klein found that the incidence of carriage of affiliated networks by vertically integrated MSOs is about 3% higher than carriage of the same network by unaffiliated cable systems. Put in a consumer context, in systems with excess capacity, consumers tend to get an extra channel (which is a program network affiliated with the MSO) and, on saturated systems, the difference in carriage of affiliated and nonaffiliated programming on vertically integrated MSOs amounts to about one channel.[1/]

It is worth noting to the Committee that in any case in which a program network feels aggrieved because it is not carried on a particular cable system, adequate remedies are available under both the Communications Act, and, in some cases, the antitrust laws.

When Congress passed the Cable Communications Policy Act of 1984, it established a federal set-aside of channel capacity in systems with 36 or more activated channels and gave the right to be carried on those channels to programmers unaffiliated in ownership with the system on which they desire to be carried. To date, this federal right has seldom been exercised. It is somewhat difficult to comprehend how the critics of the cable industry can come to Congress and complain that a problem exists

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1/ The additional network carriage figure was derived by multiplying the average number of channels in which the four largest vertically integrated MSOs have an ownership interest (7.8 channels) by 15.3% (which is the percentage by which vertically integrated MSOs are more likely to carry programming in which they have an ownership interest than do systems without an ownership interest in particular networks). Therefore, vertically integrated systems, on average, carry one additional channel of programming in which they have an ownership interest than do non-affiliated cable systems.

for program networks to obtain carriage on cable systems with whom they share no ownership equity when Congress already has created a remedy for that situation and that remedy has gone unused.

(2) Vertical Integration In The Cable Television Industry And Local Broadcast Carriage

Some broadcasters, largely independent broadcasters unhappy with the extent of their cable carriage or the channels on which they are carried, claim vertical integration is responsible for their stations not being carried on more systems, or not being carried on channels they would designate for themselves. Their allegations regarding vertical integration are often accompanied by dark allusions to a supposed anti-broadcast conspiracy among cable operators, but are not supported by the kind of nationwide data upon which sound policy can be based, or with the kind of corroborative evidence that is necessary to prove misconduct.

The reason for this is simple. Even in the absence of any federal regulatory or statutory requirements to carry local broadcast signals, virtually every broadcast television station qualified for carriage under the FCC's last must carry rules continues to be carried on virtually every cable system for which it would be qualified. Moreover, the overwhelming number of broadcast stations are carried on cable systems on channels on or below their off-air number. In short, there is no evidence that vertically integrated MSOs (or non-vertically integrated MSOs, for that matter) favor their networks at the expense of broadcasters.

Last year, NCTA commissioned the consulting firm of Price-Waterhouse to conduct a broadcast station carriage survey that measured the extent of cable system carriage of local broadcast stations, as well as carriage changes, that occurred since the FCC's last set of must-carry rules were struck down by the court in December 1987. The 3,966 respondents to NCTA's survey served 32.5 million subscribers, or over 69% of all U.S. cable customers. Given this high percentage, it is reasonable to assume that the survey data is representative of the entire cable industry's carriage of broadcast stations. A copy of this study is attached to this testimony as Appendix B.

Under the FCC's last must carry rules, which were based on a compromise between NCTA, CATA, NAB, the Association of

Independent Television Stations (INTV), and the Television Operators Caucus, broadcast stations with a threshold audience share and that met the definition of "local" were entitled to cable carriage, subject to a cap in each market.

The following are the major findings of the Price-Waterhouse survey:

(a) 98% of the broadcast stations that qualified for carriage under the last must carry rules are carried today, despite the absence of a legal requirement to do so.

(b) 97% of the cable systems would still be in compliance with the FCC's last set of must-carry rules if they were still in effect today.

(c) 91% of the systems carrying qualified stations reported no channel repositioning of these stations.

(d) 80% of the channel repositions reflect stations that were repositioned to cable channels equal to or lower in number than the station's off air channel assignments.

(e) 87% of qualified broadcast stations are currently carried on cable channels equal to or lower than than the station's off-air assignments.

The FCC also conducted its own survey of signal carriage patterns last year which produced comparable results.

A large part of broadcaster complaints about cable signal carriage appears to stem from the insistence of some UHF broadcast licensees (i.e. "high" numbered stations) that they be given preferred channel positions (i.e. "low" channel numbers) on cable systems. Notwithstanding the great change in viewer behavior which has been occasioned by the proliferation of hand-held remote controls, which allow viewers to flip up and down the dial from the comfort of their armchairs, many UHF broadcasters apparently believe that a low-numbered channel position on a cable system gives them a favored competitive position against other TV channels, particularly made-for-cable networks.

The cable industry's position, however, is that a broadcaster should not be able to claim a channel position on a cable system superior to that on which the FCC has licensed him to transmit off-air. In other words, channel 33 off-air should not have a statutory right to occupy channel 5 on a cable system, to the detriment of other cable-provided services, such as C-SPAN, CNN, etc. There is no precedent in law for such preferred treatment of UHF broadcasters, nor in logic or equity.

NCTA supports a reasonable, constitutional must carry statute. A neutral policy on channel positioning, such as mandatory on-channel assignment, could be a part of any new must carry law. This would answer the broadcasters' complaints about being "moved around." However, allowing broadcasters unilateral control over channel positioning not premised on a neutral principle, such as off-air assignment, likely would founder on the same First Amendment shoals that have seen the invalidation of not one but two sets of FCC must carry rules.

NCTA continues to be willing to work with the principal representatives of the broadcast industry to produce mandatory carriage rules similar to those which both sides agreed in 1986 were reasonable, but this time in statute and with a Congressional mandate.

(f) Vertical Integration And Competing Distribution Technologies

Mr. Chairman, I have just detailed how there is no evidence that vertical integration in the cable industry has foreclosed the market to non-affiliated cable networks. We believe as well that it has not foreclosed the development of competing technologies.

i. Background

Competition in the distribution of video programming generally occurs between distribution media within a discrete geographic market.

As I described earlier, the cable television industry was largely an extension of the broadcast television industry until the late 1970s. Cable was little more than a retransmission service for broadcasters, providing a quality picture where the ability to receive that same signal over-the-air was not as optimal. Cable did not become a competitor in the video marketplace, in any meaningful sense of the word, until it began to develop its own programming alternatives to the fare available from broadcast stations.

There can be little disagreement that CNN and Headline News compete directly with the broadcast networks' news operations, that Arts and Entertainment and the Discovery Channel compete against programming typically found on PBS, that ESPN competes against sports programming carried by broadcasters, and so on. Further, cable has found it highly effective to compete against broadcasters by serving market segments ignored by television stations. Black Entertainment Television, Nickelodeon - the children's programming network and Spanish-language networks allow cable operators to compete against local broadcasters by serving interests in the community the latter largely have ignored or abandoned.

Product differentiation is the key to successful competition in the distribution of video programming. Exclusivity over product is the means to promote that competition.

ii. Exclusivity and Federal Law

NCTA recognizes that competition thrives most vigorously in a market where programmers retain discretion to determine how and by whom their products are to be exhibited.

Federal law has long recognized that protecting exclusive rights to intellectual property both promotes competition and provides for increased diversity of information and entertainment choices. And, federal policy has recognized that disruption of these exclusive rights works against, not toward, competition.

Federal law, for example, does not mandate that a local movie theater or even a national chain of theaters is entitled to show any particular movie.

Federal law does not mandate that all of the television stations are entitled to network affiliation agreements, or forbid a network owned broadcast station from being programmed with the same network's "feed." It is well settled, for example, that NBC may license its wholly owned and operated broadcast station in Washington, D.C. (WRC-TV) as the only distributor of NBC programming in the Washington area, to the exclusion of other aspirant NBC affiliates. Moreover, federal law does not permit a cable system to use its compulsory license to import network programming over the objection of a local affiliate of that network.

The federal government recently took steps to further strengthen broadcasters' rights to exclusivity over programming. On March 21, 1989, the FCC issued an order which will reinstate syndicated exclusivity for broadcasters, so that federal law will, therefore, not permit cable to use its compulsory license to import programming from distant stations if a local station has the complete rights to a market for such programming. At the same time, the FCC broadened the network non-duplication rules by, among other things, expanding the situations where local broadcast network affiliates can prevent carriage of distant broadcast network affiliates.2/

2/ It must be noted that NCTA believes this particular set of rules, as fashioned by the Commission, will be largely unworkable for cable operators and will be a disaster for consumers. These particular rules will confuse, frustrate, and anger consumers when popular programs and out-of-town stations are dropped. NCTA opposed the imposition of these rules when the FCC began its proceedings in 1987 and we continue to believe these rules are anti-consumer. Notwithstanding our strong and consistent opposition, however, NCTA has decided not to protract the dispute further. It should also be noted that NCTA detected no real support in Congress to challenge these rules. Accordingly, the Board of Directors of NCTA voted April 6, 1989, to refrain from joining appeals to the D.C. Circuit to invalidate the FCC's new syndicated exclusivity rules.

Finally, just last year, Congress recognized the need to protect exclusivity in the Satellite Home Viewer Act of 1988. That law extends a compulsory license to satellite carriers to make broadcast signals available to home satellite dish owners. Congress restricted that license, however, so that home dish owners may not receive network programming via satellite if they have access to a terrestrial broadcast affiliate of that network. The law also ordered the FCC to see if similar protection for non-network programming is feasible.

iii. Exclusivity And "Competing" Technologies

Some satellite dish dealers and some MMDS operators, who have seen the rising popularity of cable programming, are now maintaining that they would like to "compete" with cable by selling cable network programming. This, of course, comes after cable networks and cable operators have taken all of the risk to develop their programming and establish brand name identity for it. Some groups have come to Congress and demanded that cable networks be stripped of their ability to determine how to distribute their own programming. These groups want cable networks -- from the array of competing entertainment and information providers -- to be singled out and statutorily deprived of their ability to use exclusivity as a means to compete, and further that they be deprived of the ability to negotiate the terms of distribution contracts with each distributor. It is important to remember, too, that these proponents of "competition" are not proposing to expand the diversity of programming options in the marketplace and provide consumers with more choices for entertainment and information. Rather, they simply want a federal warrant for cable programming.

iv. Availability Of Cable Programming Networks To MMDS Systems And Home Satellite Dishes

Some MMDS operators and satellite dish dealers have alleged that vertical integration in the cable industry has led MSOs to force cable networks to withhold programming from their technologies. Yet, while some individuals may not have distribution contracts for particular networks they might wish to sell, Dr. Klein's study, mentioned earlier, demonstrates that cable networks are generally available to MMDS systems and the dish community.

According to the study referred to above, conducted by Dr. Benjamin Klein, a total of 42 cable program services currently are carried by MMDS systems and Dr. Klein found that all of the top 10, and 22 of the 28 most popular basic and premium networks are sold to MMDS systems. Contrary to the claims of the MMDS interests, then, MMDS systems do offer their subscribers program services which are among the highest-rated and most popular cable networks available, including ESPN, Superstation TBS, HBO, CNN, Nickelodeon, Lifetime and MTV.

The Committee already is familiar with the availability of cable networks to home satellite dish owners. In its report in the last Congress on S. 889, the "Satellite Television Fair Marketing Act," the Committee found: "The evidence presented at the hearing demonstrated that scrambled signals of cable programming are being made available to dish owners at prices comparable to those being charged cable subscribers. At the hearing there was no dispute that all of the cable programming services that scramble now distribute their programming to dish owners. In addition, according to the FCC and the National Cable Television Association, there are over 70 program services that are not currently scrambled." The Satellite Broadcast and Communications Association reported in November 1988 that there are more than 75 program networks that are not scrambled. These unscrambled networks may be watched by home dish owners at no charge.

Dr. Klein concluded that vertically integrated MSOs are not using their ownership interests in cable programming networks as a tool to foreclose the market to competing delivery systems. Although exclusive licensing of programming is common in many parts of the entertainment business and is a well-accepted contractual element in increasing the value of copyrighted artistic works, vertically integrated MSOs are not demanding such exclusivity for their cable programming. The evidence is that cable programming networks, including those networks with affiliations to MSOs, have been made available to home satellite dish owners and MMDS systems.

The charts attached to this testimony as Appendix C detail and support this conclusion.

v. Summary

As a matter of policy, NCTA believes that cable programming networks deserve the same rights to enter exclusive distribution/affiliation agreements in a market as are currently exercised by broadcast networks, motion picture distributors, and others engaged in the dissemination of intellectual property.

Yet, as a matter of marketplace experience, cable network programming has not been withheld from consumers who choose a distribution technology other than cable.

III. Vertical Integration In The Entertainment Industry

Much of my testimony today, Mr. Chairman, has focused on vertical integration in the cable television industry. I have also described the competition we face in the video marketplace. In order to understand the effect on competition of ownership in the cable industry, it is important to understand the ownership situation of cable's tough competitors.

An examination of the video marketplace reveals it is led by a number of diversified media companies. There are many differences among them, but they share a common trait. Each has significant resources, experience, and expertise devoted to the creation, packaging, and distribution of intellectual property.

Appendix D of this testimony is the organizational charts of several leading video distributors.

It is useful to note, Mr. Chairman, that of all the competitors in the video distribution market, the highest degree of vertical integration by far is found in Hollywood. The top ten studios (ranked by box office share) control 96% of the theatrical film market, 69% of the prerecorded video cassette market, and 67% of all syndicated television programming. In addition, these ten Hollywood studios supply 60% of the broadcast network prime time programming, and are primary suppliers to, or owners of, cable networks. Moreover, the top studios have taken major steps toward more integration by purchasing 11% of all U.S. movie theatre screens, as well as broadcast stations that serve 28% of the total U.S. audience.

A chart demonstrating these numbers in greater detail are attached to this testimony as Appendix E.

Now one major studio, Paramount, is pursuing a hostile takeover of Time, Inc. If successful, they would acquire Home Box Office and Cinemax, along with ATC, the second largest cable MSO in America. If successful, Paramount would be vertically integrated in cable distribution to more than 4 million households. Another studio, Warner Communications, owns cable systems serving more than 1.5 million households. If Paramount's take-over effort succeeds, two of the four largest cable MSOs would be controlled by Hollywood studios.

The efforts of Paramount to effect a hostile take-over of Time, Inc. illustrate an instructive facet of the debate over vertical integration in the cable industry. One of the most frequent, vocal, and persistent critics of MSO investment in programming has been the Motion Picture Association of America. I must confess that this criticism has been confusing to us because, for years, MPAA attacked cable's compulsory license, characterizing it as something approaching parasitic. Now that MSOs are investing in cable networks to create their own programming, and now that this programming is rated by consumers as the best on television, MPAA apparently does not like that either. However, as you can see, Mr. Chairman, their concerns about vertical integration run only to cable operator investment in programming and do not appear to extend to vertical integration achieved by the acquisition of cable systems and networks by motion picture studios.

IV. Horizontal Concentration Of Ownership In The Cable Industry

In addition to questions about vertical integration, concerns are being voiced over recent acquisition activities in the cable industry. However, according to standard measurements of market concentration, the cable industry does not reach the threshold of concentration that suggests danger to competition.

The two prevailing measures of market concentration are the top four firm concentration ratio and the Herfindahl-Hirschman Index (HHI). The top four firm concentration ratio simply measures the percentage of the market captured by the four largest companies in the market. The HHI reflects the market share distribution among all firms in the market, giving proportionately greater weight to the market shares of the larger firms. Although the Justice Department has chosen the HHI as the appropriate measure in determining whether or not a market is concentrated, both approaches are used extensively.

The Department of Justice considers concentration a potential problem when the four firm concentration ratio reaches 50%, or when the HHI reaches 1,000.

Current data on market share of cable MSOs show low levels of concentration. Applying the HHI index to the top 20 cable MSOs, the resulting HHI value of 353 falls far below the DOJ's threshold of 1,000. Thus, according to this measure of market concentration, the cable industry is far from being concentrated.

Using the four firm concentration ratio, the conclusion is the same. According to the most recent data available, the top four cable MSOs have attained a 30% share of the cable market, a share far lower than the 50% threshold that defines a concentrated market.

V. Conclusion

In summary, Mr. Chairman:

- The television marketplace, once dominated by the broadcast networks, is now highly competitive.
- Cable television has led the way in providing consumers with an unprecedented array of diverse viewing options.

- Vertical integration has produced more programming and better quality programming choices for consumers.

- Potential negative consequences of vertical integration have not occurred.

  - Vertically integrated cable companies have not foreclosed the market to unaffiliated cable programming networks.

  - Consumer access to cable programming through competing distribution technologies has not been foreclosed.

- All of the available research and analysis supports these conclusions. Critics of vertical integration in the cable industry have yet to offer any evidence of a systematic problem in this area.

POST- HEARING QUESTIONS
OF SENATOR INOUYE

The classic test of a whether a firm has market power is: will people continue using the service when prices rise? In the cable industry, basic rates are rising, and subscribership's increasing. I understand from the industry that some -- but not all -- of this can be explained by new services are being added to the basic rate tier. Should we therefore conclude that cable has local market power?

Section 612(g) of the 1984 Cable Act contains a trigger mechanism for granting the FCC additional regulatory authority over the cable industry. Do cable systems of 36 channels or more pass more than 70% of the homes, and do these systems have a penetration level of more than 70%?

In how many areas do subscribers have access to two cable systems? Are rates lower in these areas? Do both systems have access to programming, or do certain programmers refuse to sell to "overbuilders"? Do these "overbuild" situations last, or do the two companies usually wind up merging?

We have seen many cable operators in a region buy out the adjoining cable systems. What are the economies in clustering? Do such economies extend beyond a region to the national level?

Multichannel News, on April 3, 1989, reported that John Malone is concerned about cable companies that do not have a real interest in program networks, and that he dreads the thought of paying for cable programming and then seeing that money leave the industry. That does not seem consistent with the idea that cable is dealing equitably with all interests. Would you care to comment on Dr. Malone's position?

I understand that TCI, the largest cable operator, not only owns interests in programming but also acts as an agent for other cable operators in the acquisition of programming. How many systems does TCI represent? Do other cable operators also engage in the agency activity?

How much money do cable programmers spend on programming produced by individuals (1) not affiliated with a cable MSO and (2) affiliated with a cable MSO?

The FCC recently waived this cross-ownership prohibition so that GTE could participate in the Cerritos, California cable franchise. Do you agree with the Commission's decision?

In the Viacom suit against Time, Viacom contends that each cable operator is a monopolist in his own market and that access to pay cable programming is almost entirely controlled by the franchise holder in each market. Would you care to respond to that contention?

National Cable Television Association

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July 24, 1989

The Honorable Daniel K. Inouye, Chairman
Communications Subcommittee
Committee on Commerce,
Science and Transportation
U.S. Senate
Senate Hart Building, Room 722
Washington, DC 20510-6125

Dear Senator Inouye:

This letter contains the responses to the questions you submitted to NCTA subsequent to your June media concentration hearings. The following responses correspond in order to the questions posed in your June 27 letter.

1) You observe at the outset of this question that "[t]he classic test of whether a firm has market power is: will people continue using the service when prices rise?" Because cable's subscriber levels have risen at the same time prices have increased, you ask if it can therefore be concluded that cable has market power.

We would respectfully suggest that cable's increased subscriber levels are entirely attributable to consumer perception that cable's services offer value for the prices charged. Further, to the best of our understanding, the fact that cable subscribership and prices have risen simultaneously provides no insight into whether cable possesses market power. Because this is an important matter, I would like to extend my answer somewhat.

It is well-established in the economic and antitrust literature that any firm, including a monopoly, will lose customers when prices rise, unless the product changes enough to significantly increase consumer demand. According to standard economic principles, "[m]onopolists differ from purely competitive firms in only one essential respect: they face a downward-sloping demand curve for their product.[1] Given this fact of its economic life, the firm with monopoly power knows that to sell an additional unit (or block) of output, it must reduce its prices to the customers for that unit."[2] Thus, the converse is also true: If a firm with monopoly power raises prices, it will sell fewer units.

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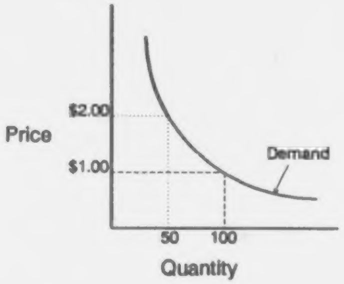
[1] Competitive firms face a horizontal demand curve.

The following chart uses this downward sloping demand curve to illustrate how firms with monopoly power lose customers as they raise prices.[3]



As this chart illustrates, if a monopolist raises prices from $1.00 to $2.00, then the quantity of goods sold drops from 100 to 50.

Thus, for either the monopolistic or the purely competitive firm, the simultaneous increase in both price and sales indicates only that customer demand has increased faster than prices.[4] In cable's case, the increased demand is in all likelihood due to consumer perception that cable programming improvements have more than compensated for the price increases.[5]

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[2] F.M. Scherer, *Industrial Market Structure and Economic Performance*, 2nd Edition (Boston: Houghton Mifflin Co., 1980), pp. 13-14. See also C.E. Ferguson and J.P. Gould, *Microeconomic Theory*, 4th Edition (Homewood, IL: Richard D. Irwin, Inc., 1975), p. 274; and Walter Nicholson, *Microeconomic Theory: Basic Principles and Extension*, 2nd Edition (Hinsdale, IL: Dryder Press, 1978), pp. 347-349.

[3] Which is not to say that a monopolist doesn't profit from raising prices. The "classic" test of whether a firm has market power is whether price exceeds marginal cost (for perfectly competitive firms price equals marginal cost). A monopolist will raise prices to the point where price exceeds marginal cost, regardless of the loss in customers or units sold. See cites above.

[4] In economic terms, the demand curve for cable services has shifted upward, a development that can occur in either monopoly or competitive situations. Increased output along with increased prices indicates a shift of the demand curve, rather than a shift along the demand curve, for either the monopolist or the competitive firm.

[5] When demand increases at a time when prices are rising, the only conclusion that can be drawn from this situation (absent major economic developments such as rapidly rising per capita income) is that the product or service has improved in a manner that has more than compensated for the price increase. This conclusion equally applies to both monopolistic and purely competitive firms.

Given that the industry's expenditures for basic cable programming have increased by an estimated 95 percent[6] since deregulation, it is not surprising that consumers have begun to value cable programming more highly, and have accordingly increased their demand for cable service. It is therefore further not surprising that a recent Roper poll conducted for the Television Information Office found that most people rate cable more highly than broadcast television for entertainment, educational, cultural, sports and children's programming.[7]

However, the basic point we would like to emphasize is that, to the best of our understanding, the trend you have noted has no bearing on whether cable does or does not have market power.

2) According to the most recent data available, cable systems with channel capacities of 36 or more do not pass more than 70 percent of the U.S. television households, nor do these systems have a combined penetration level of more than 70 percent. Cable systems with channel capacities of 36 or greater pass an estimated 44.6% of the U.S. television households. The number of subscribers to these systems, as a percentage of the homes passed, is 55.5%.[8]

3) Cable systems currently compete "head-to-head" (either fully or partially) in 41 communities in the United States. These 90 systems (see attached list) serve 1,983,629, or 3.9%, of the nation's 50,241,840 cable subscribers.

We are aware of no studies or analyses that address whether rates are lower in these communities. If we do obtain any information on this issue, we will forward it on to you.

Regarding program network sales to overbuilders, the responses to a 1988 survey conducted by Senator Howard Metzenbaum indicate that most, if not all, programmers make their product available on a non-exclusive basis to cable systems (meaning that they do not, as a matter of policy, refuse to sell to "overbuilders"). Based on NCTA's review of 17 out of the 23 programmers that responded to Senator Metzenbaum's survey, all stated that they do not offer their networks on an exclusive basis to either cable or non-cable technologies.[9]

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[6] In 1986, the cable systems spent approximately $491 million for basic cable programming. By comparison, in 1989, systems' expenditures for basic cable programming will increase to $959 million. It should be noted that increased advertising revenues have also contributed to the improvement in cable programming. Cable network advertising revenue for 1989 is projected to be 87% higher than the corresponding revenue for 1986. Paul Kagan Associates, Inc., *Cable TV Programming*, April 24, 1989, p. 2.

[7] "America's Watching," The 1989 TIO/Roper Report, March 1989.

[8] According to A.C. Nielsen's Cable Online Data Exchange, there are 1,137 cable headends in the United States with a channel capacity of 36 channels or more. Subscriber count and homes passed data are available for 88 percent, or 1,004, of these headends. According to Nielsen, these systems pass 40,802,322 of the country's 91,487,300 television households and have 22,648,019 subscribing homes.

As to whether overbuild situations wind up merging, the available evidence indicates that there have been 60 instances of merged overbuilds.[10] It is worth noting, however, that many of the currently operational overbuilds have existed for quite some time. For example, the overbuild situation in Allentown, PA involves two cable systems which have each been competing with each other for approximately 25 years.

4) Although very little information is available on the efficiencies of "clustering," our review of the trade press has identified several scale economies that have been associated with clustering. Aside from the lower administrative costs (which include the costs for accounting, finance, marketing, research, and so forth) that are associated with any increased economy of scale, clustering has been credited with enhancing the economic viability of addressable technology due to the operating efficiencies of running multiple cable systems from a common headend.[11] The increased ability to offer local origination programming and to sell advertising have also been cited as benefits of clustering.

Presumably, many of these economies extend to the national level, particularly those that result in lower administrative costs. However, as I noted earlier, little in the way of analysis has been conducted on this subject. If we obtain any additional information on cable's economies of scale, we will forward it on to you and your staff.

5) It is my understanding that in this article, Dr. Malone was making a hypothetical reference to cable programmers who do not place a high priority on reinvesting profits to produce more and better cable programming for cable subscribers. I would suggest that you contact TCI directly for a more direct statement.

6) TCI owns and operates cable systems serving approximately 6,360,000 cable subscribers. TCI further has a full or partial ownership interest in cable systems (which TCI itself does not operate)

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[9] These cable programmers include The Disney Chanel, Lifetime, ESPN, The Learning Channel, C-SPAN, The Nashville Network, Arts & Entertainment, Eastern Microwave, American Movie Classics, MTV Networks (including VH-1 and Nickelodeon, The Discovery Channel, HBO, Showtime, The Movie Channel, USA Network, CNN and the Weather Channel.

[10] Paul Kagan Associates, Inc., *Cable TV Franchising*, October 17, 1988, p. 1.

[11] Karen Edlitz, "Collecting Clusters: System Buyers Scout for New Scale Economies," *Cable World*, April 10, 1989, p. 36.

serving an additional 4,960,000 subscribers. Altogether, TCI serves, either directly or through affiliated companies, approximately 11,320,000 cable subscribers.

I presume that the "agency" function you refer to reflects the fact that TCI negotiates program network purchase prices based on the total 11.3 million subscribers encompassed by the company, thereby obtaining greater volume discounts for all systems involved than would otherwise be the case. In this regard, I think it is safe to say that all MSOs seek to obtain volume discounts that comport with the maximum number of customers represented by the company (as indeed do most businesses in virtually every industry).

7) No data are available that enable us to determine how much money cable programmers spend on programming by individuals affiliated or not affiliated with a cable MSO.[12] It is save to assume, however, that virtually all cable network program expenditures go to individuals not affiliated with an MSO.

Although networks such as HBO (affiliated with ATC through its corporate parent, Time, Inc.), and Nickelodeon (affiliated with Viacom) do produce a small amount of their own programming, only a tiny handful of program production companies are owned in whole or in part by a cable MSO. Among these program producers are Think Entertainment (affiliated with TCI, United Artists and Newhouse), Jones 21st Century (affiliated with Jones Intercable) and Paradigm Entertainment (affiliated with ML Media). Thus, the vast majority of cable network program suppliers are not affiliated with an MSO.

8) NCTA believes that the facts of the FCC's Cerritos proceeding do not justify a waiver of the Cable Act's telephone-cable crossownerhip prohibition, and we therefore strongly disagree with the Commission's decision. This decision is a complex one, and we are still in the process of reviewing the full text of the decision, which was released only last week. Nevertheless, we believe that the Cerritos decision runs counter to the Cable Act because the FCC has violated what Congress clearly intended to be narrowly construed grounds for waiver of the prohibition.

The Cable Act limits the FCC's ability to issue a waiver of the prohibition to either those circumstances where video programming demonstrably could not exist without telephone company involvement, or upon other showing of good cause. Although the FCC's Common Carrier Bureau initially found that video programming could not otherwise exist in the suburban Los Angeles community of Cerritos without GTE's involvement (a far-fetched contention given that the various "video programming" functions that the Commission has authorized GTE to undertake could easily be performed by numerous independent third parties), in its decision the FCC relied instead on the more amorphous "good cause" waiver ground.

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[12] We assume you seek information on externally produced entertainment or documentary programming rather than internally produced programming such as news or sports programming.

The FCC bases its waiver on the ground that GTE is undertaking experiments with the transmission of video programming. But waiver for "experimental" purposes seems unnecessary in view of the ability of independent cable operators to provide the video programming functions that the Commission has authorized GTE to undertake. The waiver further seems unnecessary given that there are several other experiments by telephone companies that fully comply with the statutory requirements and FCC regulations. For example, BellSouth is testing fiber optic transmission of video services, but is doing so by providing transmission facilities for unaffiliated cable franchises. Tests of new technology and services are thus currently feasible without a need for waivers of the statutory cross-ownership prohibition.

9) The dispute between Viacom and Time, Inc. involves two of our member companies, and therefore is something about which we are reluctant to take a position. I should add, however, that regardless of the specific contentions raised in the suit, Viacom obviously believes it can seek remedy for its complaints through existing law.

Moreover, as to the contention that each cable operator is a "monopolist" in his own market, I think this is more a commentary on the intensity of legal warfare being waged over these subjects than a reflection of real world market conditions. Indeed, each cable system competes against an array of video providers, including local broadcast stations, videocassette rental stores, and local motion picture theatres.

I appreciate the opportunity to provide this information. If we can be of further help, please let me know.

With best wishes,

Sincerely,

Jas P. Mooney

James P. Mooney

JPM:dag

Enclosure

Senator INOUYE. Thank you very much, sir.

Before I call upon Mr. Johnson, I would like to call on my colleague, Senator Exon.

Senator EXON. Mr. Chairman, thank you very much.

Mr. Hendricks, Mr. Johnson, Mr. Mooney, thank you for coming here. We are delving into an area that is very important to all of us.

I must leave to chair the Armed Services Committee meeting at 9:30.

I have three questions that I have given to the Chairman, and I would ask that he would ask these questions of you, and I will be reviewing the testimony because we want to work with you and the other people in this industry to clear up any potential problems that we see now or those developing in the future.

Thank you very much, Mr. Chairman.

Senator INOUYE. Thank you, Senator.

Senator STEVENS. Mr. Chairman, may I interrupt also, too. I am scheduled to testify at another hearing.

As you know, I represent an area that is one fifth the size of the United States, and we do not want to be left behind in the development of new technology because of excessive regulation.

We are doing very well now in catching up with the rest of the country, and cable has served us well along with our over the air broadcasting. And we continue to have an ability to work at peace between them in a way that services us best.

So, I want to be sure that Congress is very careful not to overregulate these industries in a way that destroys the ability to take the full extent of all of the telecommunications services into the rural areas. I thank you very much.

Senator INOUYE. Mr. Johnson.

STATEMENT OF ROBERT L. JOHNSON, PRESIDENT, BLACK ENTERTAINMENT TELEVISION, WASHINGTON, DC

Mr. JOHNSON. Thank you, Mr. Chairman.

Members of the committee, my name is Robert L. Johnson, and I am President and founder of Black Entertainment Television. I am delighted to have this opportunity to appear before the committee.

My testimony today will be brief and hopefully to the point. Before sharing with you my thoughts on the issue of vertical integration within the cable television industry and its potential impact on the public interest, let me say a few words about BET.

BET is the nation's first and only cable network providing entertainment, sports, and public affairs programming targeted specifically to the viewing interests of black cable households. BET currently reaches over 23 million cable homes in 1,900 cable TV markets across the nation.

BET is a minority owned and operated company that is partowned by TCI, Home Box Office, and The Great American Broadcasting Company, formerly Taft Broadcasting. I have attached for this committee's review promotional material about BET.

BET was founded with two specific business objectives in mind: The first, to become the preeminent producer and distributor of black-oriented entertainment to the cable television industry and, two, to become the major medium that national advertisers use to target their ad messages to black cable television households. Let me state that we are well on our way to achieving both of those strategic objectives. For the year ahead, BET projects operating revenue in excess of $30 million, and by 1992, we expect our revenue will more than double. But more importantly, Mr. Chairman, we and our corporate shareholders believe that BET's future is one of the brightest in the entire cable television programming industry. BET's future is exciting because we represent the essence of what cable television is all about—that is to distribute specialized programming to a national audience whose viewing interests are not being adequately served by conventional television broadcasting and other media outlets. In short, BET exists because there is a growing demand in millions of black households across the country for the diversity of choice which BET, only through cable television, can provide.

Let me share with you how the diversity of BET came to be and why I believe that vertical integration, especially in the case of BET, has and will continue to serve the public interest.

Go back with me about ten years ago. There were less than 17 million cable television households, only 20 satellite delivered cable services, and most of the urban markets where most black households are concentrated had no cable television penetration to speak of.

More ominous for an entrepreneur contemplating launching a so-called black television network. Interest rates were hovering around 20 percent, and very few investors or venture capitalists, black or white, were willing to gamble on an untested programming concept in a business as heavily regulated as the cable television industry was at that time, and that was basically known as a retransmission or antenna service for broadcast signals.

However, there was one individual who saw more in cable television's future and in BET's future and decided to take the risk of investing in my vision of creating a black-oriented programming service. That man was John Malone, the current president of TCI. John, who last week appeared before this committee, has been called a number of things in connection with his clout in the cable television industry. I simply refer to him as a friend, a mentor, and the man most responsible for the fact that black Americans today have dedicated to their specific viewing interests a 24-hour cable television network.

John did two things for BET. First, he invested in the business and second, he insisted that I always maintain ownership and managerial control. In addition, he gave me some very simple yet very practical business advice as to how I should operate the company. And I say this is probably good advice for the country as a whole. He said keep your revenues up and your costs down.

Fortunately, I took his advice and turned BET into a business that has been attractive enough to entice other major media companies as investors, the Great American Broadcasting Company in 1982, and Home Box Office, Time, Inc.'s pay cable subsidiary, in 1984.

In each case, Malone played a role in encouraging the new investor to get involved with BET, not only because he believed their investment was good for BET and the cable television industry, but it also because TCI had no interest in gaining greater ownership in the network. Believe me, if TCI had asked for 50 percent ownership of BET back in 1980 rather than 20 percent, I would have gladly met that demand if that was the price of making my business concept a reality. Neither TCI nor the American Television Corporation (ATC) used their distribution clout to exercise control of BET. On the contrary, they have nurtured BET, along with other specialized services that would not exist without the support of the cable operators.

BET grew with and because of the cable television industry, not only because of its relationship with TCI and ATC, which along with HBO is a Time, Inc. company, but because of the financial and distribution support it received from other industry MSOs like COMCAST, Continental, and Viacom, companies that have no ownership interest in BET but clearly recognized BET's value to their systems and their subscribers.

Viacom is particularly a strong supporter of BET, even though it owns two services that are probably of all of the programming services in the industry mostly directly competitive with BET, MTV and VH-1, since all three companies are predominant programmers of music videos.

While MTV has and continues to license music videos exclusively against BET, this fact has had no noticeable impact on the decision of Viacom's cable systems to carry BET. For example, Viacom has approximately one million total subscribers, and of that number a half a million or 50 percent have access to our network.

On the other hand, TCI, which owns part of the network, has ownership interest in 13 million homes of which 38 percent carry the network.

Clearly, these figures point out that Viacom gives more supporters as a percentage of its subscriber base than our partner, TCI. By the same token, MTV network services are widely carried by both ATC and TCI. Vertical integration is not being abused in this instance.

BET's history shows that vertical integration is not a public policy negative. Indeed, in BET's case, it is an absolutely public policy positive.

Let me explain. The Congress and the FCC are on record in support of minority ownership and diversity of programming choices in broadcasting. In fact, the FCC with congressional encouragement, has promulgated a number of regulations designed to stimulate media diversity and minority ownership. These regulatory devices, including tax certificates, distress sales policies, and minority preferences, were all developed for the sole purpose of establishing more minority ownership and diversity of media voices in the broadcasting industry.

I agree that these incentives represent good public policy, and I continue to support them. In fact, I urge this committee not to let the FCC downgrade its responsibility in this vital area.

However, I must submit that the cable television industry through their financial support of BET have done more to create minority programming and diversity in television than all FCC regulations and broadcasting outreach programs combined.

This committee should know that over the next five years the cable television industry as a whole will transfer to BET more than $75 million in subscriber fees for the sole purpose of producing more and better programming targeted to the black audience.

Mr. Chairman, I contend that if the cable television operators who have invested in BET were broadcasters, they would probably be eligible for tax certificates and other regulatory inducements for their efforts rather than being targeted for potential regulation as practitioners of vertical integration.

The cable television industry through its support of BET and other services like C-SPAN, Nickelodeon, and The Discovery Channel have demonstrated that when private enterprise is merged with consumer demand for diversity, you can achieve through vertical integration not only good public policy, but positive public benefits.

Finally, I would be remiss in my role as President of BET, Mr. Chairman, if I did not point out a glaring contradiction in this committee's examination of vertical integration within the cable television industry.

This committee is concerned about the impact of vertical integration on the diversity of choices for the public. Mr. Chairman, the greatest hindrance to BET being carried on more cable systems or even to other BETs developing is not vertical integration; it is the unconstitutional and anti-competitive requirement that cable television systems must carry broadcast signals.

Broadcast stations can reach their viewers over the air. BET is only accessible if cable channels are available.

We are currently carried in over 23 million homes. If we had an equal opportunity to get on systems required to carry duplicate network and duplicate public television stations, we could be available in excess of 30 million homes today.

The issue for us is one of simple fairness. Why should my company be treated as a second-class citizen when it comes to getting carriage on cable systems?

The courts on several occasions have agreed with us that broadcasters should not and do not have a greater or inherent right to have their voices heard in cable television households than cable programmers like BET do.

Mr. Chairman, I fully support your examination of vertical integration within the cable television industry to ascertain if there are negative consequences for the public interest. At the same time, let me conclude my testimony by asking this question. Is not a government policy of mandated must carry for broadcasters a form of government inspired and authorized vertical integration that restricts choice and limits diversity?

Thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS

Question 1. What are the economies in owning both the source of programming and the distribution outlet?

Answer. The economics in owning both the source of programming and the distribution outlet are that you have the capability to guarantee distribution and the potential to maximize revenue from both sources. For example, if a movie studio also owns theaters, they can guarantee that movie will be distributed. If the movie is a hit, they obviously would benefit from the financial upside. However, owning distribution does not guarantee a financially successful movie, only that it can be exhibited.

I think the same analogy applies to cable programming services. Owning cable systems does not guarantee programming services will be financially viable; there must be a market demand for the service.

Question 2. Do you see cable providing local news in the future?

Answer. Yes, I believe that cable systems can and should provide local news in certain markets where broadcast news does not meet the informational needs of the local community. The successful new service on Long Island is a prime example, since the broadcasters in New York ignore, for the most part, the news on Long Island. Cable has been able to successfully fill that void.

Question 3. How many cable systems are your program services carried on?

How many of those systems are owned in part by TCI or any other cable operator who has an ownership interest in your program service?

Answer. BET is carried on 1,262 systems; 24% of those systems are part-owned by TCI.

Question 4. Is your program service distributed to satellite dish owners?

Do you sell it directly to dish owners or is it a part of a package sold by another entity?

How many different companies distribute your programming to satellite dish owners and who controls those companies?

Answer. Yes, sold directly.

Question 5. Mr. Hendricks and Mr. Johnson, will the Time/Warner merger have any impact on the distribution of your program services?

Answer. No.

QUESTION OF SENATOR KERRY AND THE ANSWERS

Question. You have described how you received the financial backing of the cable operators, and this made your network programming possible. I quite agree that the programming you offer adds immeasurably to the quality and diversity of programming on TV, but my question is this.

If you have had some form of guaranteed access to a significant number of the homes with cable—as would no doubt be the case if vertical integration was prohibited, since you would not be competing with programming owned by the cable MSOs—wouldn't it be possible for you to raise money in the public capital markets, through limited partnerships or stock offerings—based on the fact that you have contracts in hand that would enable you to reach American viewers?

Answer. If Black Entertainment Television (BET) were guaranteed access, we would, of course, be able to raise money in public markets. However, vertical integration is not the primary factor in determining cable television carriage. For example, BET is more likely to be carried in systems with major black populations in the community. Consequently, we would not gain carriage over other services in markets where there is little or no black population, even if the system is owned by a BET investor.

The key issue in determining access is market demand and channel availability. I am not sure how Congress would legislate guaranteed access of certain programming without infringing on First Amendment rights. However, I must reiterate that must carry requirements are the biggest impediment to broader carriage of BET.

Senator **Inouye**. Thank you very much, Mr. Johnson.

Now, may I call upon the Chairman and chief executive officer of The Discovery Channel, Mr. John Hendricks.

STATEMENT OF JOHN HENDRICKS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, THE DISCOVERY CHANNEL, LANDOVER, MD

Mr. **Hendricks**. Thank you, Mr. Chairman.

Seven years ago in the spring of 1982 I became obsessed with the idea that cable television might, at last, provide the means of delivering documentary programming into the American home, a form of programming that by the late 1970's had all but disappeared from the networks.

I was convinced that a full channel of programming that was nonfiction and in science, technology, nature, the environment, history, travel and human adventure would be welcomed by American television viewers who were growing increasingly weary of lowest common denominator programming served up nightly by the big three broadcast networks.

Throughout 1983 I researched and wrote the business plan for the network, and by November of that year armed with the plan and a loan secured by a second mortgage on my home, I set about the difficult task of raising capital for the venture.

With start-up expenses totalling up to $9 million a year, The Discovery Channel would require capital in excess of $20 million. I searched everywhere for funding throughout 1984, approaching more than 50 companies, but no investment was secured. Finally, after a 15-month search, the investment banking firm of Allen & Company agreed to invest, as did New York Life Insurance Company. While insufficient to finance our operations beyond December 1985, just six months after the date we started transmitting, this initial $5 million investment gave us a chance to demonstrate our product directly to consumers.

By February 1986 we were out of money, and it was clear that The Discovery Channel would be forced into bankruptcy within 60 days. However, at the same time, leading cable operators, most notably TCI, were advocating that a portion of operating margins received by cable operators should be invested in programming of interest to subscribers. The theory was that more attractive alternative programming would be in the cable viewer's best interest, and this would in the long term contribute to the growth of the cable television industry.

We began discussions with TCI and other cable operators who wanted to see The Discovery Channel survive. These discussions culminated in a multi-million dollar round of financing in June 1986 involving investments by TCI, United Cable, Cox Cable, and Newhouse. Today, because of the investment of our cable operator shareholders, The Discovery Channel is alive and well and enjoyed in over 42.3 million homes across America. Today, 47 percent of all television households in America can tune in to documentary entertainment on demand, 18 hours a day.

And with this background on how The Discovery Channel came to be, I would like to make a few points. And my first point is this, Mr. Chairman. Investments that result in vertical integration within the cable television industry allow entrepreneurial programming concepts to reach the television consumer. The Discovery Channel financing history clearly demonstrates this point.

I left no stone unturned in my quest for funding and if Jack Valente continues his complaint to members of Congress about diminishing programming investment opportunities for non-cable operators, I hope you will remind him that Columbia Pictures, MCA, Universal, Paramount and Disney all declined an opportunity three and a half years ago to invest in The Discovery Channel.

Second, I would like to point out that cable operators and their shareholding interest in cable programming services have not taken steps to prevent the licensing of these vertically integrated services to competitive distributors such as MMDS. For example, our board of directors has unanimously approved the distribution of The Discovery Channel on a non-discriminatory basis to cable and non-cable operators alike. Cable operators and MMDS operators pay a license fee according to the same rate card effective on the date when our service is launched on their systems.

And I would like to conclude this opening statement by thanking the subcommittee for its key role in the development and passage of the Cable Act of 1984. That act gave programming entrepreneurs like myself a chance to get quality, wholesome and informative television to the American public through cable.

Our broadcast competition is fierce. Even in cable-wired households, broadcasters today capture an enormous 65 percent share of the viewing audience, but you have given cable networks at least a chance to compete.

By deregulating cable you have created a secondary stream of revenue flowing from consumers to cable programmers like The Discovery Channel. So, instead of being solely dependent on advertising revenue based on ratings performance, which experience shows results in lowest common denominator programming, The Discovery Channel can today purchase network alternative documentary programming financed by revenue from subscribers passed along to us by our cable distributors. And so, on behalf of our network and our viewers in over 42 million homes across the nation, I thank all of you for giving us this chance to compete.

[The statement and questions and answers follow:]

STATEMENT OF JOHN S. HENDRICKS, CHAIRMAN AND CEO, THE DISCOVERY CHANNEL

Mr. Chairman, members of the Subcommittee, my name is John Hendricks. I am Chairman and Chief Executive Officer of The Discovery Channel, a satellite-delivered programing service which I founded in September 1982.

I appreciate the opportunity to appear before you today to share The Discovery Channel's experience in the cable television industry and to offer what I consider to be compelling facts about the benefits to consumers of cable operator investment in differentiated programming services -- like The Discovery Channel -- that provide an alternative to broadcast network television.

In order to provide the necessary context for the major points about vertical integration and competition in the cable television industry which I will discuss later, I would first like to give you a very brief history of The Discovery Channel.

The Discovery Channel story is a case history about the tough realities of starting a basic cable network and about those who are willing to take the enormous financial risk of bringing a new programming service to the American consumer.

Seven years ago, in the Spring of 1982, I became obsessed with the idea that cable television might, at last, provide the means of delivering a steady stream of documentary programming into the American home -- a form of programming that by the late 1970's had all but disappeared from network broadcast schedules. And, by the way, my wife will confirm that the word "obsessed" properly describes this entrepreneur's behavior since 1982.

I was convinced, in 1982, that a full channel of informative and entertaining non-fiction programming in science, technology, nature, the environment, history, travel and human adventure would be welcomed by American television viewers who were growing increasingly weary of lowest-common-denominator programming served up nightly by the big three broadcast networks. I incorporated the venture in September 1982 in the State of Maryland as Cable Educational Network, Inc., which remains the parent company of our primary service known as The Discovery Channel.

Throughout 1983 I researched and wrote the business plan for the network and by November of that year -- armed with the plan, a loan secured by a second mortgage on my home, and a lot of enthusiasm -- I set about the difficult task of raising capital for the venture. Leasing a satellite transponder alone would cost $250,000 per month and programing rights and network operations would total an additional $300,000 to $500,000 per month. With start-up expenses totalling up to $9,000,000 per year, The Discovery Channel venture would require capital in excess of $20,000,000 as revenue would not materialize in an amount to cover operating expenses until the channel reached a distribution base in excess of about 15 million homes which could take several years. I should add that the start-up costs are much higher for an entertainment channel where programming rights fees are much higher than those paid for documentary product.

My first major fundraising presentation was made in December 1983 to Storer Communications, a large multiple system cable operator (or MSO), headquartered in Miami, Florida. My thought was that a cable operator would best understand what I was attempting to accomplish. Although the Storer executives gave me encouragement over the concept, they explained that they were deeply in debt due to the heavy costs of building their cable plant and facilities and were in no position to be an investor in a programming service.

Following the Storer meeting I focused my fund raising efforts on companies outside the cable industry after noting that Storer's debt situation and cash shortage was, in 1983, common throughout the cable industry as it struggled to wire cable throughout the country.

I searched for funding throughout 1984 but no investment was secured. Finally, after a 15-month search, the investment banking firm of Allen & Company Inc., agreed to invest as did New York Life Insurance Company. These two investments, combined with venture capital contributed by Washington, D.C., area investors and some satellite transponder time which Westinghouse contributed in exchange for stock, enabled The Discovery Channel to launch on satellite on June 17, 1985. On launch date we were available in approximately 156,000 cable households.

Throughout 1985, The Discovery Channel received a total investment of approximately $5,000,000 from the group of investors I just listed. While insufficient to finance our operations beyond December, 1985 -- just 6 months from launch -- this initial investment gave us a chance to demonstrate our product directly to the consumers.

By January, 1986 we were almost out of money. We had $283,000 in the bank on January 1, 1986; we owed $746,000 to suppliers; and had ongoing monthly losses of $600,000. Disaster struck in February, 1986 when a major $6,000,000 financing deal fell apart as the prospective investor -- a large publishing company -- decided at the last minute that basic cable programming was not a good investment.

It was painfully clear to me that The Discovery Channel would be forced into bankruptcy within 90 days. We had simply exhausted traditional venture capital sources of financing. However, Allen & Company, our investment banker, agreed to keep up the search until the end.

In mid-February, I informed Allen & Company that leading cable operators -- most notably, John Malone, President and CEO of Telecommunication, Inc. (TCI) -- were advocating that a portion of operating margins received by cable operators should be invested in programming of interest to subscribers. The theory was that more attractive, alternative programming would be in the cable viewer's best interests and this would, in the long term, contribute to the growth of the cable television industry.

Allen & Company immediately contacted John Malone who arranged for his Senior Vice President, John Sie, to begin discussions with me that included other cable operators who wanted to see The Discovery Channel survive. These discussions culminated in a multi-million dollar round of financing in June 1986 involving major investments by TCI, United Cable, Cox Cable and Newhouse Broadcasting. These four cable operators provided a capital infusion of $20,000,000 that allowed The Discovery Channel to reach operational break-even in 1988 after an accumulated loss of $17,100,000.

Today, because of the investment by our cable operator shareholders, The Discovery Channel is alive and well and enjoyed in over 42.3 million homes across America. Today, 46.8% of all television households in America can tune in to documentary entertainment on demand, 18 hours a day.

With this background on how The Discovery Channel came to be, I would like to make a few points about vertical integration in the cable television industry.

1. My first point is this, investments that result in vertical integration within the cable television industry allow entrepreneurial programming concepts to reach the television consumer. The Discovery Channel financing history clearly demonstrates this point. And we are not alone, valuable programming services like Nickelodeon, Black Entertainment Television, C-SPAN, Bravo, Turner Network Television and CNN offer appealing and broadcast-alternative television because cable operators were willing to step up to the plate and invest on behalf of their subscribers' viewing interests.

I should point out that investment funds outside the cable industry for start-up programming are scarce. I left no stone unturned in my quest for funding. Before The Discovery Channel's rescue by the cable operators, we were turned down by venture funds representing many diverse industries ranging from aerospace and automotive to mining and manufacturing. Publishing companies declined to invest as did the leading motion picture companies. If Jack Valenti continues his complaint to the Members of Congress about diminishing programming investment opportunities for non-cable operators, I hope you or your staff will remind him that Columbia Pictures, MCA-Universal, Paramount, and Disney all declined an opportunity, three and one-half years ago, to invest in The Discovery Channel.

2. Secondly, I would like to point out that cable operators, through their shareholding positions in cable programming services, have not taken steps to prevent the licensing of these vertically-integrated services to competitive distributors such as MMDS and TVRO dish distributors.

On this point, I would like to share with you the actions taken by The Discovery Channel, a vertically-integrated programming service, concerning the licensing of our service to distributors competitive with cable.

As is the case in any business where a supplier reaches the consumer through various distributors, we at The Discovery Channel (a program supplier) found it more cost effective to focus our initial staff and marketing efforts on the largest distributors and work downward. This would give us the largest possible audience in the quickest time at the lowest cost. Only by increasing the number of our subscribers could we successfully sell advertising time. As the United States Department of Commerce has noted:

> "a new program supplier must incur substantial costs in marketing its new service, negotiating and enforcing carriage contracts with cable systems, billing customers, and collecting from them. That supplier can avoid a portion of those costs if it can reach a given number of subscribers by dealing with a single large firm, rather than a group of smaller cable systems. The reduction in costs may make a new service financially viable or, more frequently, facilitate wider distribution of that service."[1]

That report precisely describes our situation. We simply did not have the resources and staff to do extensive marketing. By the spring of 1988, we were available in 27,600,000 cable households and most cable operators with 15,000 or more subscribers were carrying our service. For the first time, we were in a position to aggressively market our programming to operators having less than 15,000 subscribers each. We had a sufficient marketing staff to turn our attention to emerging distribution technologies such as MMDS which showed promise of reaching substantial households in several major markets.

Because we were faced with a situation in which competitive distributors in the same market desired access to our service, we closely examined the economic opportunities that this situation presented. Our goal was to maximize revenue. In the end, management concluded that more revenue could be generated from two or more distributors licensing our service in a single market than could be derived from one distributor (either cable or MMDS) who might pay a premium for exclusive distribution rights. On April 22, 1988 our Board of Directors concurred with this economic analysis and unanimously approved the distribution of The Discovery Channel on a non-discriminatory basis to cable and non-cable operators alike.

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[1] U.S. Department of Commerce, Video Program Distribution and Cable Television Current Policy Issues and Recommendations (1988)

A copy of The Discovery Channel's distribution policy concerning technologies competitive with cable is submitted as Appendix I to this statement. Cable operators and MMDS operators pay a license fee according to the same rate card effective on the date when our service is launched on their systems. All distributors -- cable operators and non-cable operators alike -- enjoy discounted rates as the volume of their distribution increases. Also, we have put into place a designated staff with the sole purpose of servicing the technologies competitive to cable.

So as a result, today the MMDS operator, for example, in Cleveland with 19,835 subscribers pays a per subscriber license fee lower than that of our cable operator affiliate in Medford, Oregon, who has 7,168 subscribers. A list of other cable operators who pay a higher rate for our service than do non-cable operators is submitted as Appendix II.

The factual record of The Discovery Channel's licensing policy and the factual record of the licensing policies of other vertically-integrated cable programming services that are documented in an extensive survey by Dr. Benjamin Klein[2] prove that cable operator investment in programming services in no way poses a threat to the program offerings of competitive delivery technologies. Indeed, had cable operators not invested in The Discovery Channel in 1986, Microband, an MMDS operator in New York, would today not have an all documentary programming service to offer its subscribers. Cable operator programming investment has, in fact, strengthened the programming of delivery technologies competitive with cable. But this is what happens when cable operators, who sit on my board and on the boards of other vertically-integrated cable services, participate responsibly in decision making and act solely in the best economic interests of the programming networks they have helped to create.

3. Thirdly, I would like to take this opportunity to respond to the various, unsubstantiated claims by cable's critics that cable operators favor the carriage of services in which they have an equity interest over those services in which they have no equity interest. This groundless innuendo, which suggests some

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[2] B.Klein, "The Competitive Consequences of Vertical Integration in the Cable Industry". Dr. Klein is a Professor of Economics at The University of California, Los Angeles.

The facts are this simple. Cable operators carry programming services which their subscribers tell them, through surveys, are of value. Being smart investors on behalf of their subscribers, cable operators invest in programming services which surveys show that viewers desire. Thus, it is not difficult to readily see that cable operators might tend to carry a service in which they have made an investment based on its strong subscriber value.

Subscriber surveys conducted locally and nationwide are a staple of the cable industry and have been for years. A recent nationwide survey of 600 current cable subscribers sponsored by Cable World magazine and conducted by Talmey Research of Boulder, Colorado asked subscribers to identify which cable programming services they considered to be of most value, the ones they would least like to see dropped from their cable systems. The results of this survey (attached as Appendix III) showed that the most valuable service was CNN followed by ESPN, WTBS, The Discovery Channel, and Nickelodeon. ESPN (which is owned by ABC) has in no way suffered in distribution due to its lack of cable operator investors. A.C. Nielsen reports that ESPN leads all other cable services in terms of carriage by cable operators. ESPN is available in 50.9 million households. The point to be made is that cable operators base cable network carriage decisions on documented subscriber demand irrespective of ownership interest although subscriber demand and ownership interest often coincide.

In instances where two services having similar programming formats enjoy equal subscriber interest, operators should be expected to and do carry the service which charges the lowest license fee, a decision also in the cable consumer's best interest.

Moreover, the comprehensive Klein report, mentioned earlier, analyzes cable network carriage by operators in an extremely thorough fashion, searching for any evidence of anti-competitive carriage bias based on cable operator ownership interest. None was found[3].

I would like to conclude this opening statement by thanking this Subcommittee for its key role in the development and passage of the Cable Act of 1984. That Act gave programming entrepreneurs like myself a chance to get quality, wholesome and informative television to the American public through cable television. Our broadcast network competition is fierce. Even in cable-wired households, broadcasters today capture an enormous 65% share of the viewing audience. But you have given cable networks at least a chance to compete. By deregulating cable, you have created a secondary stream of revenue flowing from consumers to cable programmers like The Discovery Channel. So instead of being solely dependent on advertising revenue based on ratings performance which experience shows results in lowest-common-denominator programming, The Discovery Channel can today purchase quality, network alternative documentary programming financed by revenue from subscribers passed along to us by our cable distributors. And so on behalf of our network and our viewers in over 42 million homes across the nation, I thank all of you for giving us this chance to compete.

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[3] Ibid, page .

JOHN S. HENDRICKS
Chairman and Chief Executive Officer

July 20, 1989

Honorable Daniel K. Inouye
Chairman
Committee on Commerce, Science and Transportation
Communications Subcommittee
Washington, D.C., 20510-6125

Dear Senator Inouye:

Thank you again for allowing me the opportunity to appear before your committee several weeks ago. I fully understand and appreciate your concern and that of your fellow committee members with matters which affect the cable television industry and the impact which our industry has on your constituents. As I am sure you have learned, the cable television industry is an enormously complex one and I believe that it is critical that we do all that we can to help you understand the extremely competitive environment in which we operate and the multitude of factors which we must take into account in the day to day operation of our business.

With this in mind I would like to respond to the questions which you and Senator Kerry submitted to me in your June 27 letter.

Questions from Senator Inouye

Question 1: What are the economies in owning both the source of programming and the distribution outlet?

RESPONSE: We are not aware of any significant economies. Cable television programmers develop packages of television programs which are then distributed via satellite to consumers either directly or through sub-distributors such as cable operators, SMATV, MMDS and distributors to the TVRO market. Since the signal is satellite delivered to a variety of distributors there are no economies of scale in the distribution process if a single entity owns both the programmer and a distribution outlet. In the case of THE DISCOVERY CHANNEL the four cable operators who own THE DISCOVERY CHANNEL pay fees on the same basis as our other distributors. They receive no special preference by virtue of their ownership interest.

Question 2: Do you see cable providing local news in the future?

RESPONSE: Yes. In fact cable currently provides expanded local news coverage in many communities. In most cases such coverage is provided pursuant to special arrangements between the local cable system operator and their local broadcast station. In other cases such as Cablevision of Long Island, the cable operator owns and operates a channel which is dedicated to providing the communities it serves with news of local interest.

Question 3: How many cable systems are your program services carried on? How many of those systems are owned in whole or in part by TCI or any other cable operator who has an ownership interest in your program service?

RESPONSE: THE DISCOVERY CHANNEL is carried in 6124 cable television systems. The number of cable television systems which carry THE DISCOVERY CHANNEL and which are owned by TCI and by other owners of THE DISCOVERY CHANNEL are as follows:

TCI - 1003 systems
Cox Cable Communications - 29 systems
United Cable Television Corporation - 55 systems
NewHouse Broadcasting Corporation - 74 systems

Question 4: Is your program service distributed to satellite dish owners? Do you sell it directly to dish owners or is it part of a package sold by another entity? How many different companies distribute your programming to satellite dish owners and who controls those companies?

RESPONSE: Yes, The DISCOVERY CHANNEL is distributed to satellite dish owners on the same basis as other subscribers. We are unable to sell directly to satellite dish owners due to the complex technical requirements of servicing this market. The following companies distribute THE DISCOVERY CHANNEL to the TVRO market on a non-exclusive basis:

Bayouvision
Cox Cable Communications
The Disney Channel
Multimedia
National Rural Telecommunications Cooperative
Netlink
National Programming Service
Telemedia
United Video
Viacom

Our records do not indicate who owns these companies.

Question 5: Will the Time/Warner merger have any impact on the distribution of your program service?

RESPONSE: The only impact the Time/Warner merger will have on THE DISCOVERY CHANNEL is that, based on our current projections, the affiliate fees currently paid by the two entities to THE DISCOVERY CHANNEL will be reduced by approximately $260,000 in 1990.

Question from Senator Kerry

Question: If you have had some form of guaranteed access to a significant number of the homes with cable -- as would no doubt be the case if vertical integration was prohibited, since you would not be competing with programming owned by the cable MSO's -- wouldn't it be possible for you to raise money in the public capital markets, through limited partnerships or stock offerings -- based on the fact that you have contracts in hand that would enable you to reach American viewers?

RESPONSE: As you may recall from my testimony before your committee, when I was attempting to raise funds for THE DISCOVERY CHANNEL I approached all the traditional sources of capital. This industry is of course one of high risks and I found that few individuals or entities were prepared to assume those risks by investing in a startup business of this nature. At the time that I was seeking my funding few cable operators were investing directly in programmers so I was not in any sense competing for distribution with programmers owned by cable MSO's and yet I was still unable to interest non-cable oriented investors in my company. Based on my own experience I do not believe that a prohibition of vertical integration will make it easier for a programmer to raise money in the public capital markets.

Please let me know if I can be of further assistance to you.

Sincerely,

John S. Hendricks

Senator INOUYE. Thank you very much, Mr. Hendricks. Before I proceed with my questions, I am at the request of Senator Exon, going to ask a few of his question.

With the current cable TV technology, is there any way that two or more cable TV companies can share the same wires and other physical connections so that a customer could have a choice of subscribing to more than one cable TV system just as telephone customers now have a choice among competing long-distance companies?

Mr. MOONEY. As a technological matter, Mr. Chairman, I do not think there would be any impediment to that, but the second operator would have to have a franchise from the local authority to offer cable service within that area, the same as he would have to have a franchise were he operating a separate plant. And that, of course, is totally apart from the business arrangement that would be necessary between the two operators.

Senator INOUYE. How many areas do subscribers have access to two or more cable systems?

Mr. MOONEY. My recollection, sir, is that in about 35 jurisdictions you have more than one cable system operating head to head throughout the entire jurisdiction, probably two or three times that number of places where they operate against each other directly in a portion of the jurisdiction, and a great number of additional places where second franchises are now currently being considered.

We will be happy to get the precise information, including locations, to our knowledge in writing to the committee.

Senator INOUYE. The committee would appreciate that very much.

Senator INOUYE. Are the rates discernably lower in those areas with two or more cable systems competing head-on?

Mr. MOONEY. I doubt if—I think it would be difficult to generalize on that, Senator, because of the varying carriage capacities of the systems and the varying demographics of the places they serve.

I would not be surprised if there were some difference from the national average, but I doubt it would be a great deal. We will look at that as well for you, of course.

Senator INOUYE. From the standpoint of your association, is it desirable to have single system or more than one system in any region?

Mr. MOONEY. Well, the single system pattern is the one we have historically grown up under, and that, of course, stems from the regulatory system under which we have grown up. Municipalities will only grant one franchise to serve that place and stage a competition for the individual company which is to win the franchise. And, as a corollary to that and in return for the award of the single franchise, the local jurisdiction typically exacts a number of economic concessions from the cable operator in the form of franchise fees, free access channels, free access studios, and in many instances concessions of things valuable which have really very little to do with the operation of the cable system itself.

And we have grown up under a pattern in which in return for the single franchise, we have built systems that are, in many respects, uneconomical and agreed to regulation which has uneconomical results. And I suppose once you're in that situation and have built and paid for the plant, you'd much rather it stayed that way.

However, we do not typically enjoy a legal right to an exclusive franchise. The vast majority of our franchises are specifically nonexclusive, and local jurisdictions retain the right to grant additional franchises at will, and so it's not something about which we, in fact, have anything to say. They can do it, and in some places they are doing it.

Senator INOUYE. Can you provide us the statistics on that, also?

Mr. MOONEY. Yes, sir.

Senator INOUYE. How many homes have access to cable and other multi-channel systems like MMDS?

Mr. MOONEY. An increasing number. Particularly in large urban markets within the past couple of years you have seen MMDS operations begin, for example, in New York, in Washington, D.C., in Cleveland, and some of the other major markets and in those markets MMDS has enjoyed some modicum of success. I suspect it will spread to the next tier of markets as well. It is a little too early to tell, though.

We have, I believe, included in my prepared testimony an analysis of all of the markets in which MMDS is present, including some subscriber counts to our best knowledge. But subscriber counts in this kind of business tend to be proprietary information, and they are not always available to us.

Senator INOUYE. I will return to my turn again, but now I would like to call upon Senator Gorton.

Senator GORTON. Mr. Mooney, I am looking at page 57 of Dr. Klein's report in which he says or at the bottom of page 56, "Anticompetitive vertical and horizontal market concentration that may develop in the future in the cable industry can be addressed by the active enforcement of our existing antitrust law."

Since, as I understand it, cable television is regulated only in a fairly narrowly circumscribed fashion by local governments and not by the Federal Communications Commission, would a solution to any of the problems with which we may find ourselves concerned, present or future, simply be solved by an express statute placing cable television under the jurisdiction of the Federal Trade Commission?

Mr. MOONEY. Well, Senator, I think that the power of local governments to regulate—and I am going to get to the Federal Trade Commission—the power of local governments to regulate cable systems is somewhat underestimated. They have quite a bit of authority under the Cable Act, for example, to require not only payment of franchise fees, but also to describe how the system should be constructed in terms of capacity. They have extensive powers with respect to consumer protection and customer service, and it is only in the rate area that their power tends to be constricted.

It is true, also, that we are subject to the existing antitrust laws and, in fact, I heard the new Assistant Attorney General for Antitrust the other day in front of another committee say that he planned to take a look at this area. And we, of course, from time to time see individuals bringing private causes premised on antitrust against specific companies.

It is my understanding that at present we are under the jurisdiction of the Federal Trade Commission, and from time to time they do take a look at us. I can recall several instances where FTC investigators have gone around the country and taken depositions from cable companies. And so, we are not free from oversight there either.

Senator GORTON. So, you would not object to this committee's including in its current Federal Trade Commission Act an explicit direction to the Federal Trade Commission to study any question that it might feel appropriate to study with respect to cable television, an express statement that cable television was subject to the Federal Trade Commission Act?

Mr. MOONEY. I do not believe we would have any objection to that so long as we were not treated differently than any other of the entertainment businesses. We have no claim to special treatment whatsoever.

Senator GORTON. Certain of the other entertainment businesses, the networks, for example, are under the jurisdiction of the FCC.

Mr. MOONEY. Well, we are too in many respects. For example, in certain technological matters, we are under the jurisdiction of the FCC. They have retained authority under the Cable Act, not only to define effective competition, which is the trigger for rate deregulation, but also to make rules with respect to ownership patterns.

I must say they have not, lately, exercised that authority in the sense of making new rules, but they are quite able to. And, indeed, there are on the books and continue to be enforced FCC rules on cable-cross ownership, for example, with broadcast networks, which do not appear in statute, but originate with the FCC.

Senator GORTON. On another subject, I must say that I believe that you make your case forcefully and persuasively with respect to the amount of choice available to the American public as they watch television, which has been created by, or at least is consistent with, the growth of cable television.

My own concern in this connection is the narrow neck that is created for most consumers, whose only practical alternative if they wish this choice, is to deal with a single cable television franchisee in the great bulk of jurisdictions around the United States.

To the extent that, we, here on this committee are concerned about that potential monopolization or control of the market, what can you suggest to us that would be most effective in seeing to it that that market was as competitive as possible and offered as much choice to consumers as possible?

Mr. MOONEY. Well, we understand that there is a great deal of concern among many members of Congress about business practices in the cable industry, and, particularly, those business practices which tend most directly to affect the consumer.

We know you are getting, for example, some mail on rates and customer service. There is a great sensitivity in the industry to that, and I think an increasingly apparent degree of self-regulation is being practiced in both of those areas.

And we recognize also that as this new medium, which generically described, is subscription television, increases in importance as part of the daily video diet of the citizenry, more and more attention will be focused on the behavior of the industry, and also on the fact that the pattern is one franchise per jurisdiction.

What would we urge you to do, though, is to look carefully at the facts and try to separate out the self-interested accusations of some of our competitors from what are facts that are capable of being ascertained by empirical evidence, and then reach judgments as to how the system might need to be fine tuned, if at all.

The General Accounting Office is to report some time later this summer on the issue of what actually has happened out there with respect to cable rates. And I think most people concede that, notwithstanding the dispute that has been going on in this city about what cable rates have done out in the country over the past couple years, the GAO study is likely to be authoritative.

I would look at things like the GAO study. I would look at things like the study the new FCC is mandated to begin later this year and to conclude with a report to Congress next year, before making any broad-ranging judgments as to what changes in federal policy may be needed in this area.

Now, it may be that some changes are needed. But it may also be that there has been less here than meets the eye.

The only thing we urge you to do is to be careful, because, fundamentally, I think cable has been a good thing. This has added competition in the video marketplace, and vastly improved the way this society uses television.

Senator GORTON. Certainly, if we were to permit the Bell operating companies to use their wires and connections with homes to provide transmission of television signals, you would have plenty of competition. Why would that be undesirable from the point of view of the consumer?

Mr. MOONEY. Well, the trouble with that is that the federal issue, the way we read it at least, the way we read the law, it is not really a transmission issue.

If the telephone companies wanted to get into the business of transmitting video into the home on a common carrier basis, I do not think there is anything in federal law, currently, which would prohibit them from doing so. They actually own and maintain the cable system in Washington, D.C., but they have to do it as a carrier. In fact, they lease it to Mr. Johnson here, who ~~in his~~ other capacity, is the principal in District Cablevision.

What the federal law prohibits, however, and what the phone companies would like to get rid of, is a prohibition on their being also involved in content. And they are prohibited, for example, from Bell Atlantic, not only owning the system, but having its own Bell Atlantic news show.

And we think that even after, even if you can get by all of the antitrust flavored problems inherent in such a situation, especially given the history of, say, the Bell Companies, you have got a very major question as to whether you want that kind of power concentrated in seven or eight companies around the country. And I suppose the state governments would also have the issue as to whether they really wanted to go out and let the phone companies take up to $900 billion out of the economy, so that they can build a system that gives people T.V. and phone service, which they have already got.

And, you know, I, personally speaking, whatever problems people have got with the cable industry, I do not think the solution to them is to be found by letting the phone companies take over the T.V. business.

Senator GORTON. Thank you, Mr. Mooney. Thank you, Mr. Chairman.

Senator INOUYE. Thank you very much. Senator Pressler.

OPENING STATEMENT BY SENATOR PRESSLER

Senator PRESSLER. Thank you very much. I do have an opening statement, Mr. Chairman.

I shall ask some questions from my opening statement. I may refer to parts of it.

By the way, I think that this hearing is one of the most important hearings on media diversity and ownership. It is a very necessary thing, because I think we have a very severe problem in our society.

Now, presently, the majority of American homes subscribe, and can subscribe to cable television. And so I would commend the cable industry for being responsible for a quantum leap forward in both the provision of information and entertainment to the consumer, and in consumer expectations. However, there are some growing problems. My constituents in South Dakota know this first hand.

Now, a large percentage of my constituents in both large and small towns subscribe to cable television. There are systems in some towns serving as few as 50 subscribers. And so this is truly penetration. But, at a certain point, cable cannot penetrate further. It is just not financially feasible to run cable to farms or ranches, or in towns of 100 people. But there are usually alternative methods of delivery. There are technologically good, financially, sound alternatives.

Anybody in my state can use a satellite dish to receive programming. Indeed, I cannot use such a dish at our home here in Washington, D.C., where we live a few blocks from the Capitol, because the historical society would object, and we cannot get cable yet. It is not available, and we cannot get the microwave cable because the Library of Congress building blocks the signal. So I am culturally deprived. But I am not talking about myself this morning.

Senator INOUYE. You are not the only one.

Senator PRESSLER. Very soon, virtually anyone living in the eastern third of my state will be able to receive cable programming, via wireless cable from one of seven regional, wireless cable networks.

My state leads the nation in terms of availability of wireless cable to its rural areas. And I am proud of the work that the REAs have done in certain areas that no one else wanted to serve. I am proud of the work that some private companies have done.

So the problem is not technology. The technology is here. Satellite delivery is not new, and wireless cable has also been proved to be successful.

The family entertainment network in Mitchell, South Dakota has been operating for four years.

So the technology is in place. The people want the programming, but frequently they cannot get it. Why can they not get it? And why can they not get it at reasonable prices? That is what I want to ask today's witnesses. What is the problem?

I think I know what the problem is. The problem is vertical integration in the cable and programming industries. Because it is a vertical integration, the programming entities have an incentive to favor their cable system partners. This favoritism is shown through price discrimination and exclusive dealings.

Now, we have recently had some better luck with some of our small cable companies, and the REAs have been able to talk to ESPN and get programming. Some of them have been able to enter into agreements.

But the fact of the matter is that the small cable companies, or the REAs are sort of brushed aside as pests almost, when they come looking for programming. And that is very unfortunate. And I know from personal visiting with some of these people who try to get the programming, that that is the truth.

And it is probably also true of small cable companies, be they in New York City or California. There is a big difference in the way they are treated when they go to look for some programming.

Volume discounts are given to large cable multi-system operators, but not to a rural cooperative of small cable systems, representing a comparable number of subscribers.

Satellite distributors find it nearly impossible to put together a programming package of similar quality and similar price to that provided by cable.

Many wireless cable systems, particularly in rural areas, are simply denied programming.

I have introduced legislation to correct some of these problems. A number of other Senators have also introduced legislation, and several bills are currently before this committee.

I hope that after these hearings, we will report some cable legislation to the Senate. Congressional interest in this issue is high. And let me say, citizens interest is very high. Because when our citizens travel, or when they go to stay in a hotel, they see what is available other places, and they want to know—they ask their Senator why it is not available to me.

There is definitely a problem with the availability and pricing of programming. And anybody who does not think there is should come with me over the 4th of July recess, when I am going to meeting with some of my local people.

Unless the industry changes its approach, I think the American people will demand some action. And that is why I have introduced my legislation.

Now, we have already gone through the business of the paper prepared by Dr. Klein, and I guess it has already been pointed out that NCTA has paid for this paper to be prepared.

I might ask if I am being cynical when I say that I am not surprised that the NCTA commissioned a paper that concludes that vertical integration is good for you. Is that a fair assumption on my part?

Mr. MOONEY. No, sir. Senator, Dr. Klein is a nationally recognized authority in this area, and I doubt very much whether he would sell his pedigree, as it were, for any amount of money.

This has the advantage of being a quantitative study. It is based on statistical analysis. And I think that, you know, while any of these—none of these things is totally immune from criticism by other members of the same profession, we think it is pretty strong and speaks for itself.

Senator PRESSLER. But I think you are familiar with my legislation, S. 168, the Cable Television Programming, Competition and Consumer Protection Act of 1989. The purpose of my legislation is to give competing technology such as wireless cable reasonable access to programming, by bringing cable under the antitrust law.

Do you object to this approach, or will you support this legislation and why?

Mr. MOONEY. Well, we think that all of these businesses, these companies are subject to the antitrust laws right now. We know of no reason to suppose they are in any way exempt. I guess to the degree that we have a disagreement, it is really a disagreement over facts.

It is our understanding that this programming is not in any systematic way being withheld, either from the backyard dish market, or from the wireless and MMDS business. And that to the degree that there are disputes, they are mostly disputes, as I suggested in my oral testimony, over who gets to keep the margin.

I mean, we have got two programmers right here, and I am not sure what their policies are with respect to MMDS distribution, but I would be willing to bet that they want to get as much distribution everywhere, through whatever system as they could possibly get, because they get more revenue as a consequence.

I do not know what their policies are either with respect to bulk discounts, but I think there are a number of legitimate——

Senator PRESSLER. Well, why is it that my constituents who head small cable companies and REAs, in particular, complain to me? Are they making this up? Or, what can I say to them?

Mr. MOONEY. Well, Senator, without knowing the specific nature of each complaint, and what it is exactly they are complaining about with respect to which company, it is very difficult for me to give an answer to the question because I really do not know what their specific complaint is, but if it is, for example, the issue of——

Senator PRESSLER. All right. The CLA Empire Electric East River Association of South Dakota, which has been a pioneer in providing microwave service, why do they have a hard time getting programming?

Mr. MOONEY. Well, I do not know, Senator. I do not know which programming companies they have approached for what, but I would not be surprised if what they have got is a dispute, not over access, but over price.

Senator PRESSLER. Well, that is probably true. Of course, it is—well, first of all, it is access. ESPN has finally come around and come forward, but when they try to have a meeting or call somebody, their calls are not returned. They will say, "We will call you in a week, or call you in a month." They are just not interested in serving them.

Mr. Mooney. Well, you know, ESPN is not a company vertically integrated with the cable industry. They are owned by ABC/Cap Cities.

Senator Pressler. Then let us say HBO, or—I am not really into—some of my constituents have got a problem. How can we solve it then?

Mr. Mooney. Well, I think that for starters, if we could get your constituents to spell out precisely what is their problem——

Senator Pressler. Oh, we have done that. We have done that.

Mr. Mooney. You know, I would be happy to put them in contact with the relevant programmers.

Again, I know of no programming company in the cable industry that has a policy against MMDS distribution. And I do not——

Senator Pressler. Would you be willing to help finance a study of exactly what the smallest cable companies pay for programming compared to the big ones by somebody? I mean, we are—I think you would find that they are treated totally differently than those that are partially owned by, or otherwise connected with the programmers.

Mr. Mooney. I think I would probably have some trouble getting data on that, because most pricing is regarded by these companies as proprietary. But, again, you have got two programmers here——

Senator Pressler. All right. But I first want to get your views. Do you think there is—do you believe me that there is a problem out there?

Mr. Mooney. I believe that there are differentials, discounting, if you will, charged by some programmers to cable operations based on size. But it is my understanding, at the same time, that the companies that do so believe they have legitimate business reasons for pursuing those practices.

Let me just give you an example. One example I know about. There is a group of smaller cable operators, who I gather, have been after HBO for some time to give them the same price that the small operators understand that some of the big operators get. And they would like to have that lower wholesale price, presumably, so they can get more margin on their retail sales.

But HBOs position is, well, if I give that to you, am I going to get any additional subscribers out of it? What is in it for me? Am I just going to get the same subscribers, but less money?

And, again, according to the HBO people, the answer from the smaller operators has been, "No, you are not going to get any more subscribers, but we are going to pay you less."

And it is over things like that that deadlocks sometimes occur, and it is very hard for me to say as a strict matter of equity who is right.

And it is not a thing on which the trade association, of course, has a position because it involves pricing, and we are not allowed under the antitrust laws to get involved in that at all.

Senator Pressler. Okay. So what should I say to my folks when they complain that they cannot get a response on buying programming, and when they do they feel that the pricing is—that they are dealt with much differently. Should I just tell them that this is tough?

Mr. **Mooney**. I think one thing you have to make a judgment on, assuming you are satisfied you have got all the facts, is whether this is the kind of complaint that should be cognizable by a legislature. I mean, is this the sort of thing that ought to be altered by law?

Senator **Pressler**. Well, they are asking me now, what can we do about this problem? What should I tell them?

Mr. **Mooney**. Well, again, if there is a problem, actually, of these people getting in touch with programming services, I would be happy to help you out.

Senator **Pressler**. Well, then after they get in touch, I can assure you, there is a problem in pricing.

Mr. **Mooney**. Senator, I am not in a position where I can come out for your bill.

Senator **Pressler**. But I want to know what you recommend I tell them. I will be out there now for two weeks. What should I tell them? I want some script here.

Mr. **Mooney**. I think you might tell them that they can keep trying, or alternatively, you know, with all respect——

Senator **Pressler**. That will not work.

Mr. **Mooney**. With all respect, Senator, you are putting me in an impossible position here.

Senator **Pressler**. Well, this position I am in——

Mr. **Mooney**. Because you see, I do not think that they—I do not think they, necessarily, have a good case. But I understand fully, of course, that you may not be in a position to say that to them. And I understand——

Senator **Pressler**. Well, I think they do have a good case. I think that we do need to get this information out. I do think we do have, and I would say the same thing about inner cities. And I would say the same thing about other places where it might be difficult to—where you might have small companies.

But let me ask now—what is your opinion of the reinstatement of the must-carry rule? I am told that a number of local, independent broadcasters have been removed from their local cable systems—particularly those owned by large MSOs, since the must-carry rule was vacated.

Mr. **Mooney**. We, I have said publicly on a number of occasions, going back 12 months now, that we would be happy to cooperate with the broadcasting industry, to recommend to the Congress that Congress enact into statute the most recent must-carry rule, which, of course, was the result of an industry agreement between my industry and the respective broadcast organizations, including the independent broadcasters.

That has been stalled, however, by two things. The first is the apparent linkage made between this issue and a number of members of Congress, and the so-called fairness controversy, in which the broadcasting industry is being asked to make a concession with respect to the Fairness Doctrine. And, of course, you know that is not something we can control.

The second is the insistence of some members of the broadcasting industry that the compromise that was made several years ago on must-carry be expanded to include requirements for the channel positioning on cable systems of the broadcast signals.

And our response to that is—you seem to have two problems here. One is broadcasters' complaints of "being moved around." And the answer to that is to give them a legally enforceable right to be in a specific place from whence they cannot be moved at the discretion of the cable operator.

The second part of it is, where is that? And we think that the most reasonable place that they should have a right to be—in fact, the most obvious place is on the same channel as assigned to them by the FCC for their off-air operations.

If they are channel four from the FCC, they ought to be channel four on the cable system. If they are channel 33, they ought to be channel 33. Unhappily, the broadcast trade associations do not seem to be able to reach the same conclusion. They want to create a situation in which channel 33 has got a right to be channel four.

And I guess I could understand some commercial reasons why they want to do that, but I do not think it holds up as a matter of objective public policy. And it certainly does not hold up with these gentlemen, who are cable programmers, who think they ought to have the same crack at channel positioning as do members of the broadcast industry.

And it remains stuck on that issue, and I do not know what to do about it.

Senator **Pressler**. Cable often says you ought to take a risk in programming, and I know some of this has been covered, but is it not true that HBO and Showtime have exclusive arrangements with every major studio with the exception of one? How are competitors supposed to develop their own programming when the product is locked up?

Mr. **Mooney**. Some of the motion picture product which is distributed by HBO and Showtime is distributed by them on an exclusive basis, not all of it. As a matter of fact, the trend appears to be the other way. But my understanding of those exclusivity arrangements is that they hold exclusive rights only so far as the cable distribution market, that those exclusivity rights for the most part do not run to other distribution markets such as MMDS, back yard dishes, and so forth.

Senator **Pressler**. Let me also say that I note one of the questions that staff prepared says that C-SPAN is not on very many cable systems around the country, relatively speaking, and that was one of the great benefits that Congress was not promised, but why is C-SPAN on so few cable systems around the country?

Mr. **Mooney**. Actually C-SPAN I is on most cable systems and reaches the vast majority of the cable subscriber population.

Now, C-SPAN I, of course, covers the House. C-SPAN II arrived sometime later, when the Senate moved just a couple of years ago.

Senator **Pressler**. What percentage of stations is C-SPAN I on? Maybe you do not know that.

Mr. **Mooney**. I will supply the exact information for the record, but I believe it is available to 70 percent of our subscriber base, which is about 35 million households.

Senator **Pressler**. I had some statistics on that. I do not see them right here, but to conclude——

Mr. **Mooney**. I should add that it is the objective of the cable industry to carry both C-SPAN I and C-SPAN II on a universal basis and so as soon as our channel capacity allows us to do that, I expect we will do so.

Senator **Pressler**. So, to summarize your statement, then, and I am speaking, in fact, on July 5th to the Valley Empire Electric Association about programming, and I can report to them that your advice to them is to keep trying?

Mr. **Mooney**. And my comment on that in addition is that, you know, this is—that we are not insensitive to the fact that many people feel very strongly on both sides of that issue, and there is room here for reasonable differences of opinion.

It simply happens that in this instance the industry association is not in agreement with them. But, of course, I guess the point is that some of the programming services are not either, and these are legitimate differences of opinion between businessmen who I think are guided by legitimate commercial concerns, and there is no evidence whatsoever of any dark conspiracy or any collusion going on here.

Senator **Pressler**. Well, there is a problem out there, and I will continue to work on it through my legislation, and I am disappointed that you are not more cognizant of the problem that does exist or you seem to be, and I would like to continue our discussions.

Senator **Inouye**. Thank you.

Senator Kerry.

Senator **Kerry**. Thank you very much, Mr. Chairman.

Mr. Mooney, I have a number of questions, but I am not going to ask all of them now. I must just submit a few for the record because I know they want to move on to the next panel, and I have to move on to about three other hearings. But when the Cable Act was passed in 1984, it essentially deregulated the rates that the cable operators charged their subscribers, but it did obviously reserve the power to the local communities to be able to set the basic rates in those communities where there was not "effective competition."

A lot of folks feel today that that effective competition standard is perhaps unrealistic because it has been defined in a way that include virtually every American city and town in the definition.

Therefore, the question arises whether we should revise the effective competition standard in a way that perhaps includes access to the alternative technologies like MMDS and so forth. What is your reaction to that?

Mr. **Mooney**. I have a twofold reaction to that, Senator.

We have submitted just this morning to the committee a pretty detailed study of vertical integration in the cable industry which was done for us by Dr. Benjamin Klein of UCLA and which, so far as we can tell, is the only thorough quantitative examination of vertical integration in this industry that has been done insofar as resulting behavior goes.

And Dr. Klein has found that there is no systematic withholding of programming from other distribution media, including specifically the back yard dish market and the MMDS market, but that to the degree you tend to have disputes, for example, in the MMDS market, it is really not so much over access as to who gets to keep the additional margin resulting from MMDS's lower capital and operating cost.

As to the effective competition standard, I think that Congress anticipated in 1984 that this was a fast growing industry, likely or at least potentially to have a market influence on the whole world of television as we know it in this country and, therefore, built into the statute a requirement that six years out, which is to say in 1990, next year, the FCC conduct an inquiry of the whole question of the status of competition in these markets and specifically what had gone on with basic rates.

It is my understanding that the FCC intends to begin that inquiry this year taking into account the study of a major study by the GAO on cable rates which is scheduled to be released by the GAO, I think, later this summer, perhaps August, and make its findings available to Congress together with whatever legislative recommendations it feels appropriate on a timely basis next year.

And so I think that there is in existence the machinery for initiating a careful look at this beginning in the FCC, but ultimately, of course, up here where the authority really lies in this area.

Senator KERRY. Well, I appreciate that, and I think it is important that you acknowledge that, but I would like to perhaps get a sense of whether or not you, at this point in time, based on your—I mean, I can understand why you want to wait until then to have the evaluation, but do you think that evaluation cannot be made on its face to a certain degree today just by virtue of what we are seeing in some of these cities?

Mr. MOONEY. I think it is very difficult to do that, very difficult to get facts for some reason in this area.

I think one of the reasons is obviously that cable television is something which is increasingly important to a great many people. It is something that you have actually in your home, and people tend to be a little emotional about it, and I say that in the context of having previously observed that we know that we have got some problems out there on rates and customer service.

I think at the same time it seems to be a somewhat emotional subject because television in general and entertainment in general are enormously competitive business, and it is part of the style of these industries to hurl political accusations back and forth at each other in Washington.

I think that this area needs to be looked at. I think scrutiny by the Congress of the entire world of television is very important, given the role that television plays in this society. But I think that it is very helpful to have the regulatory agency involved too because they are designed and equipped and so far as I can tell intended by Congress to, among other things, perform fact-finding functions.

And I fear that unless very thorough and dispassionate analysis is done in this area, the government might end up doing something which would prove to the ultimate detriment of the society with respect to the major question which is what use are we as a society going to make of television.

And all that our experience over the past 10 years is that the use we make of television has been enormously expanded, I think to the public's benefit.

Senator KERRY. Oh, I think it has. I do not think there is an argument about that here.

There are obviously a lot of underlying questions raised by virtue of that expansion. I mean one of them, for instance, you know the merger mania that is currently taking place is seeing significant acquisitions of cable systems for three or four times what they cost to build.

Now, I am told that a suburban system costs something like $700 per subscriber to put into place, but the systems are currently selling for about $2,800 per subscriber with significant bank loans and junk bond acquisition facilitation.

The result is that the consumer winds up paying not for program improvement or choice expansion and so forth, but for the acquisition costs.

And I suppose one of the questions that we should be thinking about is whether or not we should be thinking of a price cap linked to maybe Consumer Price Index or something for rate increase for cable systems that recently changed hands or maybe even in that antic trafficking rule similar to one that used to apply to broadcast stations. How do you react to that?

Mr. Mooney. I think that—I have heard some talk of a potential anti-trafficking rule, and for all I know, the cable industry might actually support something like that because most of our people do not appreciate either the bad publicity or bad politics that results from some of the asset players out there pushing prices as hard as they can with the expectation that they will roll the system in a few years and get out and go live in Palm Beach or something. The long-term players are very sensitive to that.

I think that you have to be careful, though, when you start generalizing about what systems are selling for. Yes, you can probably sell a state-of-the-art cable system with 50 percent penetration for $2,800 a sub, but there are two reasons you can do that. One is that because it is state of the art, it does not require a lot of immediate investment in rebuilding the plant, and the second is that there is plenty of room there for subscriber growth.

But if it is a not quite up to par system with penetration of, say, 65 percent, you are not going to get $2,800 a sub because you do not have that much upward growth. I mean, everybody says $2,800 a sub. I read in the paper now even $3,300 a sub.

But it's tough to generalize. I am a limited partner in a cable system which is being rolled over right now in which we are going to get something like $1,950 a sub. I wish we were getting $2,800 a sub.

Senator Kerry. Well, let us say there is a price of $1,400 instead of $2,800, half price. That is still double the new start-up, buildup cost. Why are more people not building? Why are there not more overbuilds or second system competition? Are people in effect paying the monopoly premium?

Mr. Mooney. I have seen a theory to the effect that any difference in the selling price of a system versus the replacement cost of the system represents a monopoly profit, but I really do not think that particular analysis stands up to examination because it suggests that the value of any business should be simply the replacement cost of the hard assets without attention being paid to the fact that it is an up and running business with a subscriber base and cash flow and so forth.

I mean, you know, if you are going to buy Woodie's, you are not going to get Woodie's for the cost of the downtown store and the value of the leases on the suburban malls. Any business is valued not just on the hard asset basis, but on the basis also of it being a going concern.

Now, do you have in some places too much money being paid for some systems? Yes, I think you do, and Senator Gore earlier talked about a situation that he has experienced in Tennessee where—and this is my spin on it—the new buyer probably paid too much for those systems and, as a consequence, had to jack the rates up to a point which represented a very substantial increase, 40 or 50 percent in the basic rates, and did not give the customers anything additional.

But the other thing that has happened is that at least in some of those communities overbuilt franchises have been granted, and I understand that the recipient of the franchises actually intends to overbuild, and what happened there is that the capital investment of the owner of the original system had got to be so great that he had to push his prices up to a point where it made it economical for somebody to come in top of him and incur the kind of construction costs you are talking about and then also experience the operating and programming cost and still be able to significantly underprice the first guy. And that, I submit, is probably a heck of a loss to the first guy.

I think as this industry matures you are going to see some similar economic situations develop, and there may be a lot more of that, assuming local governments will agree to the second franchise.

Senator KERRY. That brings me back to the original question about the definition effective competition. I mean, if we were to change that definition, do you think we might invigorate that capacity for investment and overbuild?

Mr. MOONEY. The—what the statute says is effective competition, and then it leaves it to the FCC to define that, although there was very extensive legislative history which pretty clearly spelled out not only that the Congress expected the result to be rate deregulation, but also that it expected it to be based upon a broadcast signal standard and that it was going to be less than four broadcast signals.

Having said that I understand, too, the point that has been made in other fora by people who have been critical of us to the effect that that was then and this is now.

And the cable industry traditionally does not simply stonewall the Congress or other policy-making bodies when issues of this kind arise because we understand they are real and they are premised on real policy concerns and real consumer concerns, too.

We are not in a position today to recommend changes in the Cable Act, but we are certainly in a posture where we are going to pay awfully close attention to that FCC proceeding, understanding that it will likely not end with the FCC but that whatever the FCC does will at least be reviewed up here for its adequacy.

And, in that respect, all I can say is it is not inconceivable to us that either the FCC or the Congress may determine that some adjustments in the existing policy are necessary.

The only thing I would ask now is please do not simply throw us back into the clutches of the city councils. I mean, that did not work, that was an awful situation which subjected us not really to disciplined, intellectually sound regulation, but to a kind of hurly-burly political regulation that deterred the development of cable in this country quite substantially.

Senator KERRY. Were you asked previously about how phone company intrusion might affect you?

Mr. MOONEY. Yes.

Senator KERRY. Well, then, I will not reask that and I will check the record on it.

Now, obviously there is a fair mix today, fair in terms of just the number of programming. You know, you have got the premium or pay services, HBO, Showtime, Disney and so forth. You have got some independents. You have got some vertically integrated conglomerates, some who are not, some independents, some not, and so forth. But it appears as though more and more programmers are competing for a limited number of channels on most cable systems.

Is there is a legitimate concern that as that pressure increases the less profitable programs—I mean the carrying of public television and the carrying of some of the other, you know, clearly non-money-makers not advertising efforts are going to be pushed off in order to allow more of the advertising revenue to come on?

Mr. MOONEY. A threefold answer to that. We understand it to be an important part of our business and very much a requirement of our subscribers that we carry the broadcast stations, including the PBS stations, and we do carry them.

We are experiencing one of our periodic crunches in channel capacity. When the Cable Act passed only five years ago I think the average channel capacity of a cable system was between 20 and 24 channels. Today it is between 36 and 42 channels and we are rapidly moving toward a 54 channel standard.

Very few new builds, for example, have channel capacities under 54, and a lot of rebuilds are going to 54 or even beyond, and so I expect that to loosen up somewhat.

But, third, I would go back to the study we presented to the committee for us, and Dr. Klein of UCLA who says there is no discernable pattern of non-affiliated programming services being excluded from carriage on cable systems and he says, in fact, that the vertically integrated cable systems tend to carry a somewhat greater number of non-financially related programming services than the non-vertically integrated companies, and that is possibly because a lot of those companies tend to have slightly greater channel capacity than the others.

Senator KERRY. Do you think we should consider some any kind of congressionally mandated allocation programming like third-one third cable-owned programming, local broadcasting, independent programming, something along those lines?

Mr. MOONEY. I hope you would not until and unless somebody actually came up with some clear, fairly specific empirical evidence that there is something wrong going on here. I mean, there are an awful lot of allegations being thrown around, but very, very little in the way of proof. I mean even threshold proof. People do not seem to think that they have to prove these things anymore, that they can just assert that this is going on, and everybody will assume it is so.

Senator KERRY. I do have some additional questions, Mr. Chairman, for the record. I would ask if they could be submitted in writing for the record.

Let me just say—I understand Jay Leno has suggested the home shopping network is going to merge with C-Span, so people can have the convenience of buying political favors at home.

Do you care to comment on that? Just tell me it is not so, please?

Mr. MOONEY. Well, I do not know. Assuming that C-Span would be able to keep its nonprofit status, I think we would leave that to the——

Senator KERRY. Well, according to the current vernacular, they would make a hell of a profit. Mr. Chairman, it is back to you.

Senator PRESSLER. Mr. Chairman, may I just say one more word here?

Senator INOUYE. Senator Pressler.

Senator PRESSLER. You wanted a specific example. I have been given one. The family entertainment network of Mitchell has been trying to get the HBO for four years without success. And they took three years to get a conversation going. You might look into that.

Also, I am told that no rural MMDS in the country has access to HBO, and you might take a look at that, if you are unaware of the problem.

Mr. MOONEY. I will look into it, Senator.

Senator INOUYE. Thank you very much. I just have a few more questions and I will submit most of mine in writing.

I would like to make a few observations. I think today's hearing is a classic example of scheduling conflict. Right now there are 14 hearings being conducted throughout all three buildings, and a major one in the Armed Services Committee. Half of the members of the subcommittee belong to the Armed Services Committee. And I am sorry to tell you that ICBMs are considered much more important than cable.

The other matters are very serious, and this is in response to Mr. Mooney. I would like to assure you that this Committee will not precipitiously act to legislate changes to the 1984 Act. This is just a part of our oversight responsibilities. And if our investigations strongly suggest that we should consider changes, we will make them.

And in accordance with that policy, may I invite all of you witnesses to look over your transcripts, and if you wish to make clarification, corrections, addendums, additions, supplementals, et cetera, because this is the record that we will rely upon, if we are to make any changes. And so I hope you will do so very carefully and take advantage of that.

Mr. Mooney, I am certain you have heard from all of the members of the panel. And foremost in their minds would be their concern that reflects the concerns of their constituents on the pay rates on the rates.

The Committee has received evidence which suggests that there are many operators who raised their rates 50, and in some cases

100 percent. But when there is a huge outpouring of concern, they roll it back.

Does it suggest that there are operators who follow the old Hong-Kong investment policy of 20 years ago, that if you cannot recover your investment in two years, that investment is a bad one?

Mr. MOONEY. I do not think so, Senator. And I am completely unaware of any such pattern in the cable industry. As a matter of fact, the only place I can say with reasonable certainty that that occurred, is in the situation that was raised by Senator Gore.

Senator INOUYE. Also in Hawaii, too.

Mr. MOONEY. They rolled it back? Well, the Senator knows how chagrined we are with some of the difficulties you have had in your own state. I do not think that that is a pattern, and I hope you will allow me to add this.

Frequently, when people say, "Oh, the cable rates here were increased by 70 percent, or 100 percent," they are only telling part of the story. Lots of times that involves a tier consolidation, where two separate tiers, one of which was taken by a relatively small proportion of the subscriber base, are put together with the result that most pay no more, and in some instances, that a lot of people pay less. That, for example, was the situation in Denver last year. Yet, that did not stop a lot of people from running around saying, "Oh, the rate was increased 70 percent." It was not. For the majority of the subs, the rate went down a dollar.

Frequently, when people make these charges, they also do not take into account either accompanying reductions, or elimination of fees for things like second set hookups or remote controls, or reductions in the fees for things like pay services.

In other words, in summary, I think it is hard to simply isolate the basic rate as the total story. The relevant thing, in our opinion, at least, is the bill the subscriber pays. And while the bill that the subscriber pays, undoubtedly, has gone up in the past couple of years. It has been, by no means, by as much as a lot of our detractors would have it.

According to the Department of Labor's Bureau of Labor Statistics, over the two-year period immediately following deregulation, the net subscriber bill paid by the average subscriber went up 14.5 percent. And that is not peanuts, but on the other hand, it is not 70 percent or 100 percent either.

Again, this is a complicated area that requires some sorting out. And we, of course, want to do our best to help in that process.

Senator INOUYE. Does your association monitor the rate activities of its members?

Mr. MOONEY. No, we do not. But we, obviously, are very interested in other people who do that on a commercial basis, and we pay great attention to what the BLS says about our numbers.

And then, of course, there is this study which has been underway at the GAO since last year, with which we have cooperated. And I understand they have gotten a 70 percent response rate from the questionnaire they sent to cable operators, which is an enormously high response rate.

And so I think you are going to get a good sound study of that, with reliable results.

Senator **Inouye**. Congressman Markey recently introduced legislation that will restrict foreign ownership of cable systems. Do you have any thoughts on that?

Mr. **Mooney**. We support the general policy. Congressman Market proposes to amend an existing provision in the Communications Act, which limits foreign ownership of broadcasting and telephone properties. Now, what he proposes to do, in essence, is to add cable to the prohibition.

And we have said, to his sub-committee on the other side, that we support the policy, in general, for the reasons stated by the author of the bill.

We have urged, however, that they take a little care here in watching out for potential retaliation by foreign governments against U.S. systems—U.S. companies that have investments in cable systems, particularly in the United Kingdom and Scandanavia.

And that they also take some care to look at the possible, indirect affect this might have on U.S. programming companies doing joint ventures, or foreign distribution deals, particularly in Europe.

All the programmers are very jittery about the 1992 situation with the EEC.

Senator **Inouye**. Mr. Hendricks, how many cable systems carried The Discovery Channel before the infusion of capital buying cable operators?

Mr. **Hendricks**. We were carried in about six million homes. And I believe, at the time, by somewhere around 700 to a 1,000 cable systems.

Since the time of the investment by the four cable operators, we have grown substantially. We have grown to a point today where we are available in 42.3 million homes.

The bulk of our growth has been in cable systems that do not have an equity interest in The Discovery Channel.

At present, 27 percent of our carriage is through the four cable operators who have invested in us, and the balance—over 70 percent—is through the non-equity holding cable operators.

Senator **Inouye**. Mr. Johnson, it has been said often in the Capital, that capital markets work and that investment capital is readily available for startup adventure. But your history would suggest that that is not so.

Am I correct in my observation?

Mr. **Johnson**. Yes, you are, Senator. It would have been extremely—it is still extremely difficult now for an investor, and particularly a minority investor to get financing for programming ventures, because most people do not finance ventures with unreliable assets like programming until you have established a proven track record.

So 10 years ago, when black entertainment television started, without operator support—in this case, TCI, I doubt very seriously if the business would have come about at that time.

Senator **Inouye**. I have many questions that I would like to submit to you. For example, on the 1984 Act prohibition on telephone companies owning cable systems, and I would like to get your thoughts on the GTE participation in the California cable franchise—and, also, on "must-carry."

And so I have several questions that I would like to submit to all three of you, because we just cannot continue. I notice that time is flying, and we have a large panel to follow you.

So, gentlemen, I thank you very much for your assistance this morning. And my invitation stands—if you do want to make additions, corrections, clarifications, addendums, supplements—please feel free to do so.

Mr. **MOONEY**. Thank you, Mr. Chairman. Thank you for your courtesy, sir.

Senator **INOUYE**. Our next panel consists of the following: Mr. John Hanks, Director of the Bureau of Franchises of the City of New York, Mr. Robert Schmidt, President of the De-wireless Cable Association, Mr. Preston Patton, President of the Association of the Independent T.V. Stations, Mr. Bob Phillips, Chief Executive Officer, NRTC, Mr. Harry Shusam, III, Vice-President, National Economic Research Associates of Washington, and Mr. Gene Kimmelman, Legislative Director of the Consumer Federation of America.

Mr. Shooshan will be testifying at the request of the United States Telephone Association.

I thank all of you for your patience and your participation this morning. I hope you have noted the high level of interest shown by members of this Committee on what is happening in cable and broadcasting out in the hinterlands. And so your assistance this morning will be very important.

May I first call upon Mr. Hanks?

STATEMENT OF JOHN L. HANKS, DIRECTOR, BUREAU OF FRANCHISES FOR THE CITY OF NEW YORK

Mr. **HANKS**. Thank you, Senator. I am here representing the City of New York this morning. And we have a very keen interest in the subject of this hearing today.

I have an extensive statement which I request be made part of the record; and since we have a large panel, I will only provide a brief summary of the major concerns of the City.

Senator **INOUYE**. I can assure you that all of your statements will be made part of the record.

Mr. **HANKS**. My major concerns deal with the vertical and horizontal integration and consolidation that is now taking place in the cable industry. In the City, we have had recent occasion to deal with these issues. The proposed consolidation between Time Incorporated and Warner Communications Inc. would affect six of nine cable franchises in the City, 92 percent of the existing subscribers in the City, and 60 percent of the households, which amounts to 1.74 million households. So, when all the cable systems in the City are built, approximately 1.74 million households out of 2.9 million households would be served by a single company, assuming that the Time-Warner consolidation is consummated.

The City approved transfer of control petitions by these companies, pursuant to the City's authority under the franchise agreements. As a condition of those transfers of control, the City imposed obligations for these companies to act in certain ways and to refrain from acting in other ways. The City sought through these obligations to help alleviate its concerns about vertical and horizontal integration problems that might result from the consolidation. A copy of one of the transfer of control resolutions is attached to my testimony.

Now, Mr. Mooney earlier said that vertical integration is not peculiar to the cable industry and he is quite correct about that. But what is somewhat peculiar to the cable industry is the horizontal monopoly, which can be a very small monopoly or a large one. But, in any event, when you combine a horizontal and vertical monopoly, you have a very potent weapon which may result in anti-competitive effects. That is what has concerned us.

We are not, in the City, opposed to vertical integration. It has many benefits. It will allow cable companies to compete in international markets. In some cases, it encourages the development of programming because it removes some of the risk from the development of programming. We are not unaware of the benefits of vertical integration, but we are concerned about the potential negative effects that vertical integration combined with horizontal consolidation brings with it.

One would think that the way to handle the possible negative effects from vertical integration is not to prohibit vertical integration, but to focus instead on specific negative effects that develop.

Mr. Mooney also suggested that he cannot find any evidence of negative effects resulting from vertical integration. I just happen to have a complaint letter here of the type which I receive on occasion. The letter is from a company called Liberty Cable. If I may, I will just read a few words of it.

It says, "Liberty Cable is a large SMATV cable company providing television services to New York City residents." I should put that claim in context. They call themselves large even though they have less than one percent of the subscribers in Manhattan. But, that is the only kind of competition the larger cable companies have in the City.

The letter states: "HBO outright refuses to sell HBO or Cinemax to us. Madison Square Garden refuses to sell Madison Square Garden to us below 86th Street due to an exclusive arrangement they have been forced to give Manhattan Cable—which is the cable franchisee in southern Manhattan. Turner will not sell TNT to us directly in order to improve their position with ATC. They have said that we can buy TNT through Manhattan Cable or at Paragon Cable—which is the cable franchisee in northern Manhattan—at a 67 percent markup."

I guess that is what Mr. Mooney meant when he was saying that the real argument is over wholesale margins—at least in some cases. Contrary to what he said, if Liberty Cable's allegations are correct, there has been a refusal to deal by some companies that are vertically integrated on fair terms with Liberty Cable. The letter alleges that there has been a refusal to deal on the part of the Madison Square Garden Network, an independent sports programmer, that has an exclusive arrangement with Manhattan Cable, a company owned by ATC, which is vertically integrated.

Further, the letter implies that there has been an attempt by TNT and two cable franchisees to secure a large profit margin on TNT programming. Now, with regard to those margins, most wireless systems cannot compete if they must purchase popular programming at inflated prices. Wireless cable companies are already at a competitive disadvantage if they compete in the same market as a cable company since they do not have the same product. They cannot offer as many services since they do not have as many channels. They must offer their services in order to compete at all at lower prices than those offered by wired cable services. Yet, they will not be able to sell their product at a lower price if they have to pay inflated prices for programming.

So, the argument that Mr. Mooney was making—that somehow the programmers should have a right to try to secure the margin that separates wireless cable companies from the price charged cable companies with larger numbers of subscribers—would be incorrect. If wireless cable companies were to pay those rates, they could not survive in business. These are the only viable competitors cable companies currently have. Even though they are small, we believe that they should be protected in their development, and we encourage congressional protection of that development.

I suggest a relatively simple, but I think a fair way, to encourage such development and curtail the harms of vertical integration. I would recommend that Congress consider legislation that would reverse the burden of persuasion in cases brought by wireless and independent cable operators, programmers, and subscribers allegedly harmed by a cable operator or its affiliated programmer's anti-competitive behavior. Once a party, such as an MMDS company, has established a prima facie case of discrimination, then the burden of persuasion should shift to the defendant to show that it had acted reasonably under the circumstances.

It is, in a way, a minor idea which could have a major impact. It is a simple solution to a major problem since it would require companies possessing essential evidence to prove whether they have acted reasonably or not. It allows them to come forward and to make their case that the discrimination that they practice is reasonable and is something that the court should accept as a way of doing business. Right now the evidence is in their possession, but it is the plaintiff that must, somehow, produce it.

There is precedent for the shifting of the burden of persuasion in tort law, remedies law, and even under the price discrimination prohibitions in the Robinson-Patman Act. So my suggestion is not without precedent. The shifting of the burden would be useful, for example, in situations involving independent programmers that are denied access to a cable system, or it could be used in cases in which a wireless cable system challenges an exclusive programming contract.

Another major concern of the City deals with increasing competition in the delivery of cable services. Realistically, we do not see substantial competition for some time. Whatever the reasons, it is not because the City does not want competition. We do want competition. But it does not appear that the marketplace will sustain it at this time.

We, therefore, believe that one significant act which Congress could undertake to improve competition is to take another look at Section 626 of the Cable Act. The procedural and substantative rules for renewal under the Section are so stringent that it is virtually impossible for a franchising authority to deny renewal. A company has to be horrendous—at least by their lights—before a franchising authority can deny renewal. There have not been many cases under this section yet, but at least the wording suggests that the cities have to give cable companies an opportunity to cure any defaults under the franchise before denying renewal on such grounds. The City has two cable franchisees up for renewal right now. It will be very interesting to see how they come out because these two franchises have been abused for over 18 years, and the people—subscribers and non-subscribers—have been abused.Yet, it will be quite difficult for the City to deny renewal.

The renewal process should become an opportunity for cities to bring some competitive pressure into the process that would, perhaps, help to hold rates down and to increase the quality of cable service. If the cities were permitted to extend requests for proposals during the renewal process, and then choose the best applicant for the franchise, at least there would be an opportunity to see whether the cable companies, which profess to be willing to compete, do in fact compete in terms of what they are willing to offer the towns and cities of this country.

Cable companies are entitled to an opportunity to make profits. If they were to lose their franchises under a competitive renewal process, then I think they are entitled to be justly compensated if they have not recoverd their investment during the franchise period.

Under a competitive renewal process, at least the cities and the towns would have an opportunity to pick the best possible cable company since they would know something about the history of the cable franchisee up for renewal. Right now, Section 626 has a tendency to create a perpetual monopoly for cable companies that already have a natural monopoly. I would urge the Senate and the House to take a long, close look at that Section and consider amending it along the lines I have suggested.

Finally, I would like to comment on Mr. Mooney's comments about cable rates and to caution you as you look at a cable rate statistics over the coming months. The City, for example, over half of our subscribers only subscribe to basic service. And then we have subscribers that subscribe to one form or another of a premium service.

As to the subscribers that only take basic service, I think you want to break out those numbers from statistics combining increases in premium and basic services. Most people, at least in the City, subscribe only to basic, and that is where the major increases in prices have been.

Many of the rate statistics melt the increases in premium services, which in most cases, were never regulated with increases in basic. Since many premium prices were already at highs, you would not expect as large of increases in premium prices as have occurred in basic prices after deregulation. Therefore, I think statistics combining the two are a little misleading.

If you focus just on increases in basic rates, you will get a sense of how subscribers subscribing only to basic have been affected by dramatic price increases. In Manhattan, for example, over 50,000 subscribers have experienced a 74 percent increase in basic rates in the four years after deregulation. The balance of basic-only subscribers in Manhattan have witnessed a 44 percent increase. These increases compare unfavorably with the little over 14 percent increase in the Consumer Price Index during the same period. So, I just caution you on how these numbers are used in statistics you might review which measure cable rate increases since deregulation.

[The statement follows:]

TESTIMONY OF JOHN L. HANKS
DIRECTOR OF THE BUREAU OF FRANCHISES
FOR THE CITY OF NEW YORK
BEFORE THE UNITED STATES SENATE
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
SUBCOMMITTEE ON COMMUNICATIONS

June 21, 1989

Mr. Chairman, Members of the Subcommittee, on behalf of the City of New York ("City"), I thank you for the opportunity to testify here today on how dramatic increases in vertical and horizontal integration in the cable television industry since passage of the Cable Communications Policy Act of 1984 ("Cable Act") may severely limit the ability of franchising authorities to protect the public interest in quality cable television services and limit competition in the cable industry.

The City has been and continues to be a leader and innovator in the communications and entertainment marketplace. In 1970 we granted two cable television franchises to cover Manhattan, which set the municipal regulatory standard for over a decade. The Manhattan franchises required that: (1) service be made available to all residents; (2) the cable operator set aside channels for leased, municipal and public access; and (3) the operator maintain a state of the art system.

In 1983, we again established the national standard for reasonable regulation of cable television when we granted franchises to cover the remaining four boroughs in The Bronx, Brooklyn, Queens and Staten Island.

But our ability to protect the public's interest in the provision of quality cable services has been severely restricted by unanticipated results and restrictive interpretations of the Cable Act, and by the economic structure of the cable industry that is now emerging. Although I will later discuss several other issues of particular concern to the City, I would like to focus my primary attention on two areas where the Congress could produce a far reaching, procompetitive effect by making very simple - but important - changes in, or additions to, the Cable Act. Those two areas are: (1) the renewal provisions of the Cable Act and (2) the possible negative effects of the evolving vertical and horizontal integration of the cable television industry.

In 1983 and 1984, when Congress was considering cable legislation, there was much talk of throwing off the shackles of regulation and allowing the cable television industry to flourish in a fresh environment of competition. It has flourished, but in monopoly profits, not competition. Part of the reason for this is Section 626 of the Cable Act, which established the procedural and substantive rules that govern the renewal of cable television franchises.

A question may be asked: Is it good public policy to have national legislation which almost virtually guarantees a perpetual franchise to franchisees who, as a practical matter, hold a largely unregulated monopoly in the delivery of cable television services in almost all jurisdictions? The answer is obviously no. Yet, this is, I believe, exactly the effect of Section 626 of the Cable Act. The renewal issue is important since it is often only at renewal that a franchising authority has the opportunity to correct one result of monopolization -- the failure of a cable operator to improve the quality of cable services during a franchise term.

Although the Cable Act was passed in late 1984, only recently have courts, cities and cable companies grappled with the meaning of the renewal provisions under Section 626 of the Act, since cable franchises expiring within 30 months of the effective date of the Cable Act were not covered by Section 626. While Section 626 reflects what was thought to be a balancing of the interests of cable operators and franchising authorities in the renewal process, the City has found that, in reality, the complex and ambiguous renewal provisions may make it extremely difficult to deny a cable operator renewal of its franchise.

As a result, a cable operator does not have an incentive to provide quality cable service. The cable operator assumes that a franchising authority's threat not to renew the franchise if services are not improved is just that -- a threat, which the franchising authority has no means to back up under the current renewal restrictions.

It is suggested that what a cable franchisee is entitled to is a fair opportunity to make profits and that if that opportunity is denied at renewal, an appropriate return on its investment. A cable franchisee is not, however, entitled to a perpetual monopoly without public accountability. Public accountability can be achieved by permitting franchising authorities to issue requests for proposals at the end of the franchise term. In that way, the marketplace becomes the test for whether the franchisee has been offering a quality product at a fair price. It would be ironic, indeed, if one of the most monopolistic aspects of the cable industry resulted not from market forces, but from the actions of Congress in having passed Section 626.[1]

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[1] Section 626 also creates an unhealthy regulatory

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The second area I would like to focus on is that of the negative effects of vertical and horizontal integration in the cable industry. The possible anticompetitive effects and effects on the quality of cable services resulting from a lack of competition are of special concern to the City. The proposed combination of Time Incorporated ("Time") and Warner Communications Inc. ("Warner") affects six of the nine cable franchises in the City. Three are controlled by Warner Communications and three are controlled by American Television & Communications Corporation ("ATC"), which is a Time subsidiary. Time currently owns or controls service in all of Manhattan and in western and central Queens. Warner owns or controls service in northern and eastern Queens, southern Queens and western Brooklyn. If the proposed Time-Warner combination becomes a reality, these six cable

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[Footnote continued from previous page] environment for relations between a municipality and a franchisee. As the Section 626 process is now structured, the municipality must create a record of having notified the franchisee of any breaches of the franchise or violations of law and of having given the franchisee an opportunity to cure. The whole process can become extremely adversarial and unproductive of the public good. Yet, without the giving of notices of breaches, etc., municipalities have little bargaining power, and they may literally be at the mercy of the franchisee. Under Section 626, one can expect to see many "take it or leave it" renewal franchising contracts in the future, for the cities and towns have been stripped of almost all bargaining power.

franchises will come under the control of the consolidated company. As a result, 60% of the City's cable households will depend on this cable and programming giant for cable television services.

Nationally, the proposed Time Warner Inc. ("Time Warner") will reach more than 5.4 million subscribers. The company will have cable operations in 36 states, including 15 which presently have both ATC and Warner cable systems.[2]

Overall, Time and Warner are part of a growing $14 billion cable industry which is available to almost 80 million U.S. homes. Despite the growth in the industry, however, MSOs have garnered a larger share of the cable market. In 1980, for example, the five largest MSOs provided access to only 29 percent of all cable subscribers; now those MSOs account for more than 40 percent of all cable subscribers.[3]

I am concerned with the effects that this increasing concentration of cable ownership might have on competition and on the quality of cable services, in both the cable television industry as a whole, and in the City in particular. I am especially concerned that such combinations will result in even higher basic cable service rates and will lessen the incentive cable operators might have to improve the quality of their cable service and to implement technological advances.

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[2] Solomon, "The Meaning of the Merger," Channels, June 1989, at 62.

[3] Harris, "D.C. Puts the Heat on Cablers," Variety, April 13, 1989, at 1; Kriz, "Communications Focus," National Journal, April 29, 1989, at 1085.

Consistent with its authority under the Cable Act, the City has tried to minimize any adverse effects on cable service quality and competition that the proposed Time Warner combination might have on the City's cable systems. For instance, in considering whether to grant its consent to the combination, the City was concerned with, among other matters, its impact on the obligations of the ATC and Warner cable franchises within the City to provide state-of-the-art cable systems and services, and could have on the continuing availability of a diversity of programming and programming sources in the City. Further, the City was concerned about the competitive implications of the concentration of control by Time Warner over the provision of cable services within the City.

As a condition of its consent to the transfer agreement, the City obtained Time and Warner's agreement to several conditions which the City hopes will alleviate some of its concerns about possible negative effects resulting from the combination.[4] First, the

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[4] I am submitting a copy of one the

[Footnote continued on next page]

City obtained the companies' agreement that their cable systems in the City would offer a wide diversity of national, regional and local news, entertainment, sports, public information and other categories of programming from a wide array of programming sources, including affiliated and unaffiliated entities. Second, the City obtained Time and Warner's agreement that neither the companies, nor any programming affiliates which they actually control, would engage in any actions that would unreasonably deny cable programming to competitors operating in the City. Thus, Home Box Office (HBO) (a subsidiary of Time) cannot unreasonably deny its programming services to a competing satellite master antenna television (SMATV) system within the City and Manhattan Cable Television (MCTV) cannot enter into exclusive contracts with the Madison Square Garden (MSG) sports programming service that would unreasonably deny MSG's programming to a competing SMATV system.

We also secured the companies' agreement that they would take no action that would be unreasonable with regard to the marketing, promotion, positioning and

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resolutions in which the City consented to the transfer of control of the ATC and the Warner cable franchises to Time Warner. I believe the resolution will give the Members of the Subcommittee a sense of the difficult issues franchising authorities must deal with in protecting the consumer interest in cable services. See Attachment.

other terms under which it distributes cable programming services of unaffiliated programmers to its subscribers.

Residents in the City already have firsthand knowledge of how a cable operator may use its market control to promote programming in which it has a financial interest to the detriment of programming in which it has no financial interest. In 1986, the New York Citizens Committee on Cable Television filed suit against MCTV.[5] The Committee argued that MCTV favored affiliated programming services such as HBO, and refused to carry competitive unaffiliated programming services such as Showtime, even though MCTV had channel capacity to carry such competitive programming. Although the case was settled, MCTV agreed to offer a competitive pay service not affiliated with Time, and to add another unaffiliated pay service after it expanded the system's channel capacity.

Studies have shown that MCTV's alleged actions are not atypical. Professor Michael Salinger, a professor of public policy at the Columbia University business school, has found that cable operators do indeed tend to favor their own cable programming over that of other companies. Specifically, Salinger found that ATC cable systems tend to favor HBO and Cinemax, in which Time has substantial ownership interests, and to discriminate against other programmers. Further, Salinger found that Viacom-owned cable systems tend to favor Showtime, a Viacom programming affiliate, at the expense of other programmers.[6]

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[5] New York Citizens Committee on Cable Television v. Manhattan Cable Television, Inc., C.A. No. 86-CIV-859 (S.D.N.Y., filed Jan. 29, 1986) (raising both antitrust and Cable Act claims).

The assurances that the City secured from Time and Warner are welcomed, but may not be sufficient. I would suggest to the Congress that it consider an amendment to the Cable Act which would, in each of these areas, do a simple thing: place the burden of justifying potentially anticompetitive conduct on cable operators and their affiliated programming services; that is, once a plaintiff competitor, unaffiliated programmer or subscriber establishes a prima facie case of discrimination, the burden of persuasion or of justifying the alleged anticompetitive conduct would shift to the vertically integrated, horizontal monopolist provider of cable services with regard to whether the provider or cable operator acted reasonably in denying or frustrating a competitor or potential competitor's attempts to compete. Under this new standard, if it appears that a cable operator discriminated against an unaffiliated programmer in the terms and conditions of access to its system, or that the operator unreasonably favored affiliated programmers over unaffiliated programmers in the way it marketed services to subscribers, or that the operator's affiliated programmers discriminated against other operators or other would-be distributors of affiliated programming in the price or other terms of sale of such affiliated programming, then the cable operator or its affiliated programmer would have the burden of demonstrating that their actions were reasonable, either because their actions had a counterbalancing procompetitive effect or because their actions promoted a sufficiently compensating diversity of programming in a cable market. Where the factual context - here horizontal monopoly and vertical integration - supports an inference of possible wrongdoing and the relevant evidence is in the hands of the party to whom the burden of persuasion is to be shifted, there is support for a shifting of the burden of persuasion in several areas of the law, including remedies law, torts law, and even in the antitrust context within the price discrimination prohibitions under the Robinson-Patman Act.

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[6] Greenwald, "Tune In, Turn On, Sort Out," Time, May 29, 1989, at 68.

Thus, if it were to appear that HBO, for example, denied its services to an SMATV system competing with MCTV on the grounds that the SMATV system failed to adequately protect against the theft of its signal, HBO would have the burden of persuasion in showing that its actions were sufficiently procompetitive as to be reasonable. Similarly, if MCTV entered an exclusive contract with ESPN for the provision of National Football League Sunday night games, which contract denied a competing SMATV system access to those games, MCTV would have to demonstrate that its actions were sufficiently procompetitive as to be reasonable under the circumstances, rather than discriminatory. Finally, if subscribers to MCTV had to first subscribe to HBO as a condition of purchasing an unaffiliated movie channel, or had to pay a higher price for such an unaffiliated service, MCTV (and maybe HBO) would have the burden of persuasion in proving that its actions were reasonable, either because of a counterbalancing procompetitive effect or because of compensating increases in the diversity of programming in the cable market.

It may be that vertical integration has positive effects, such as allowing the United States to compete in the international communications and entertainment markets, and it may be that for the time being there is no realistic and effective competition to cable. But we need not accept the bad effects with the good. The shifting of the burden of persuasion to cable operators in the cases described above would help suppress the negative effects, while not interfering with the benefits of vertical integration.

There are several other areas of concern for the City. Because of Cable Act constraints in those areas, the City remains severely handicapped in its ability to protect cable consumers. In the remainder of my testimony, I will briefly outline the problems in those important areas (although not the only areas) in which Congress might consider measures which might help alleviate some of my concerns about a city's inability to curtail the decline in the number of cable operators in the cable industry and to spur improvement in the quality of cable services. Further, I will broadly define possible solutions to problems in those areas which could generate competition in the cable industry and which should protect the public interest in quality, yet affordable, cable service.

The major area of concern is the dramatic increase in cable rates since passage of the Cable Act. The temptation of a cable operator to raise rates has been fueled by recent court decisions and FCC regulations which have severely limited the power of cities to regulate rates under Section 623 of the Cable Act. Last year, for example, the FCC implemented regulations defining "effective competition" under that section which make it impossible for the City -- and virtually every other jurisdiction in the country -- to regulate rates. Under the new rules, cable systems are deemed to face effective competition (and therefore are not subject to rate regulation) if at least three over-the-air television broadcast signals (not necessarily the same three signals) are available in 100 percent of a cable community. All sections of the City are currently deemed subject to effective competition under the FCC standard.

As a result, the City and virtually no other municipality can regulate cable rates which, as a whole, have increased at a rate much higher than increases in any of the national price indices since deregulation under the Cable Act. Basic cable rates for some City residents have increased 74 percent since passage of the Cable Act. Nationally, cable rates have risen an average of 32 percent since Congress passed the Cable Act.[7] Price increases are likely to continue if MSOs pass consolidation or merger costs on to the consumer.

I should note here that Congress should be cautious when confronted by statistics regarding rate increases. There has on occasion been a tendency to meld basic and premium cost increases together. They need to be looked at separately. For example, a majority of the City's cable subscribers subscribe only to basic service. They are unpersuaded by statistics that combine basic and premium rates together, since they have experienced cable increases in their basic service rates and receive no benefits from price increases in premium services.

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[7] Harris, D.C. Puts the Heat on Cablers, Variety, April 13, 1989, at 1.

Given that cable operators do not face viable competition from other cable systems in almost any municipality, the only constraint on prices under the current regulatory regime would be a decrease in consumer demand. Since cable is becoming an essential source of information and entertainment for many subscribers, cable operators may be able to impose substantial price increases before the loss of revenue from cable subscribers choosing to disconnect their cable service exceeds the increased profits from such price adjustments.

Another issue of concern involves the continued viability of local television broadcast stations. The ability of a cable operator to threaten the viability of local television broadcast stations has been enhanced by the judicial elimination of the FCC's must-carry rules and by the repositioning of local television broadcast stations on cable systems by cable operators. The FCC's must-carry rules were invalidated by the courts as "incompatible with the First Amendment."[8] Section 625(d) of the Cable Act eliminated the power of franchising authorities to prevent cable operators from realigning their service offerings and corresponding rates on service tiers not subject to rate regulation.

As a result of the Cable Act and judicial rulings, cable operators have argued that they have unfettered discretion over the channel placement of local television broadcast stations and over whether to carry such stations. For instance, as a result of the elimination of the FCC's must-carry rules, WNYC-TV, the City's municipal broadcast station, is finding its continued viability threatened. Although there are 69 cable systems within its viewing area, only 35 of those systems carry WNYC on a full-time basis. Hence, many cable subscribers are being denied access to this station, which offers alternative programming in several different languages to viewers in New York, New Jersey and Connecticut. The continued carriage on cable systems of other commercial television broadcast stations in the City, which New Yorkers have traditionally depended on for local news and entertainment, are also endangered as a result of the elimination of must-carry rules and the power of franchisees to place such stations at undesirable channel locations.

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[8] Century Communications Corp. v. FCC, 835 F.2d 292 (D.C. Cir. 1987), cert. denied sub nom. 108 S. Ct. 2014 (1988).

Another issue involves the inability of cities to impose meaningful technical signal quality standards on local cable operators, which may have no competitive incentive to improve signal quality. Last year, the City challenged FCC limits on its power to regulate technical standards. This challenge culminated in the Supreme Court holding that the FCC did not exceed its regulatory authority under the Cable Act by forbidding the City and other local authorities from imposing technical standards "more stringent" than those set forth in the Commission's regulations for Class I cable channels (those carrying over-the-air broadcast signals).[9] In reaching its decision, the court relied primarily on the fact that Congress, in passing the Cable Act, did not disapprove of the FCC's pre-Cable Act position that it had the authority to preempt local technical standards.

In bringing the suit against the FCC, the City sought to ensure that its cable franchisees provided adequate signal quality to the City's cable subscribers. Under the FCC's antiquated Class I standards, cable operators are not required to implement technological innovations which would improve signal quality on their cable systems. I believe it is widely recognized that the FCC standards are inadequate to ensure a level of signal quality acceptable to consumers, and I am disturbed that the FCC plans to impose its Class I standards on Class II, III and IV cable channels, which carry basic, pay and public access channels. If all classes of cable channels are subject to the FCC's antiquated standards, neither the City nor any other municipality will have the means of ensuring that their residents receive the signal quality they deserve from their cable operators, unless such operators voluntarily agree to tougher standards.

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[9] City of New York v. FCC, 108 S. Ct. 1637 (1988).

A final issue also related to a city's ability to ensure that a cable operator provides quality service, involves a city's right to enforce a cable franchise. Although many franchise agreements contain penalty provisions applicable when a cable operator breaches terms of the agreement, at least one court has stated that such provisions are not enforceable during a modification proceeding pursuant to Section 625 of the Cable Act.[10] In Montgomery County, the court enjoined a franchising authority from enforcing the penalty provisions in its franchise agreement, pending resolution of the cable operator's request for modification of the agreement. The ruling allowed the cable company to stay liability for past franchise breaches simply by filing a Section 625 request for prospective modification of the franchise provision that the county alleged the cable operator breached.

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[10] Tribune-United Cable v. Montgomery County, 784 F.2d 1227 (4th Cir. 1986).

I am concerned that this interpretation of Section 625 may impair the ability of franchising authorities to enforce franchise obligations to which companies agree, but later decide to ignore. I am also concerned that a similar court ruling in the future might extend the Montgomery County holding to impair a city's right to enforce franchise provisions during a renewal proceeding. If Congress does not pass legislation making it clear that a franchisee cannot stay liability for past breaches during a modification or renewal proceeding, then a franchising authority's power to protect the public interest in quality cable service will be further eroded.

As you can see, there are numerous issues in need of legislative redress. I have identified some of the most important, but there are many others. When Congress passed the Cable Act, I believe it felt that the measure would foster competition and technological innovation. However, the reality is that the cable industry has become a virtual unregulated monopoly and that there have not been significant improvements in the quality of cable services on most cable systems since passage of the Cable Act. If the goals of the Cable Act are to be achieved, Congress must pass corrective legislative measures which promote competition in the cable industry and which foster the development of other multichannel video programming distribution sources as viable competitors to cable operators. Until such competition materializes, Congress must also pass measures granting franchising authorities the means to curtail the negative effects on cable service to subscribers that the lack of competition in the cable industry engenders.

In order to promote competition, Congress must pass measures which would promote competition in the cable television industry by prohibiting cable operators and cable programmers affiliated with cable operators from discriminating against unaffiliated cable operators in the provision of cable programming. Further, Congress must pass measures which would prevent cable operators from discriminating against unaffiliated programmers in the terms and conditions of access to a cable system and in the marketing of affiliated and unaffiliated programming to subscribers.

Moreover, legislation is needed which would prevent or discourage cable operators from removing, or changing the channel position of, local television broadcast stations. Finally, in the future, Congress might consider removing barriers to the entry of telephone companies ("telcos") in cable television markets within their local service areas if Congress finds that such entry will stimulate competition and technological development, and if Congress can implement safeguards which would prevent cross-subsidization and other anticompetitive effects resulting from telco entry.

In terms of solutions until such competitive measures are in place and the cable industry becomes vibrant and competitive, Congress must grant franchising authorities power to regulate basic cable service rates in those areas where cable operators do not face effective competition from other cable operators or from other multichannel video programming distributors. Moreover, legislation is needed which would allow franchising authorities to establish technical signal quality standards more stringent than the antiquated standards the FCC currently imposes on Class I cable channels and proposes to extend to the other three classes of cable television channels.

In addition, Congress must pass legislation which would clarify that franchising authorities have the right to enforce franchise provisions (pursuant to the enforcement and penalty terms in a franchise agreement) during renewal and modification proceedings. Finally, Congress must pass legislation which would streamline the complex and ambiguous renewal provisions in the Cable Act, which make it difficult for franchising authorities to deny renewal to cable systems which are not adequately serving cable subscribers.

* * *

I have just outlined some of the issues and possible solutions which must be considered if the competition and technological innovation that Congress hoped would result from passage of the Cable Act is to materialize. Until such actions are taken, vertical and horizontal concentration in the cable television industry will continue, and franchising authorities, whose hands are tied under the current regulatory regime, will not have the power to curtail the resulting anticompetitive effects or to ensure that the nation's cable television subscribers get the quality of cable services they expect and deserve.

Senator INOUYE. Mr. Hanks, you have suggested that big is not necessarily good, and expressed your concern over the Time-Warner merger. Having said that, did the City of New York approve or disapprove this Time-Warner merger?

Mr. HANKS. The City of New York did not actually vote on the merger. They voted on the transfers of the franchises. And they voted to approve those.

I should add that we do not think that big is necessarily bad, especially when it is located in the City. Warner, Time and Paramount all have their corporate offices in the City.

Senator INOUYE. So, in the case of these three, you do not mind an overwhelming involvement in your cable distribution?

Mr. HANKS. Sir, we are very concerned about it. And that is why, with your permission, I have included a copy of the transfer of control resolution as to one franchisee for the record[1] as part of my statement. You will be able to see from the resolution the great pains the City went to to condition its approval on provisions that I hope might help temper the effects of this very large consolidation.

Senator INOUYE. Thank you.

Mr. Schmidt.

STATEMENT OF ROBERT SCHMIDT, PRESIDENT, WIRELESS CABLE ASSOCIATION

Mr. SCHMIDT. Mr. Chairman, thank you very much for the opportunity to be here today with you. I am not here as an anti-cable person; I am a cable person. I think my credentials ~~can speak~~ for themselves. They are not in my prepared remarks, so I would like to take a minute and identify my background for the purpose of this hearing and for some of the other members of the committee.

I am a cable operator. I am also a wireless cable operator. I am the former president of the National Cable Television Association, from 1975 to 1979, when the theme of the organization was "let us compete." That theme now has been shifted; it is called "let us keep."

I hired Bob Johnson and gave him his first opportunity in the cable business, and encouraged him, when he came to me with the idea to start Black Entertainment Television, to do ~~it, because~~ I think it is a fabulous service.

I think the Discovery Channel is a fabulous service. I think C–SPAN is an unbelievable service. And I am disappointed they are not here today to cover this hearing, because I think this is a very important hearing.

But we are not here to talk about those issues. We are here to talk about media concentration and the impact on consumers and the public.

I am convinced that this is an institutional problem now. It is not a matter of this personality or that personality. I have the highest regard for John Malone, President of TCI. I think he has been very forthright in his representations before the U.S. Congress. What we are talking about now is monoply power. And the cable industry has now accumulated enough power that that power is being abused. And I think that the public is paying for it.

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[1] The submission was not reproducible.

What we can do about it is a whole separate issue. I would like to go back to a few points that relate to, the spin on things, as Mr. Mooney says.

I think, unfortunately, this thing is being cast as sort of a marketplace problem between potential contenders. But I think the bottom line is the public has nobody speaking for them. This is the only forum where the public has an opportunity to be represented. You represent the public.

I am going to try to simplify the issues, because I think these issues can be understood. You do not have to be a totally knowledgable person of the cable television industry to appreciate what is going on. The examples cited earlier in western Tennessee are not the exception, they tend to be the rule. There is no recourse today for check and balance of this industry.

The industry has grown very rapidly. It has become more than just a casual entertainment medium. It is one of the most powerful forces in America today; 55 percent of the people of this country have cable television. Another 20-or-so percent have it available, but they choose not to take it.

But the balance of the people of this country do not have cable television, and they are second-class citizens as far as I am concerned, with television, because cable, using its monopoly position, has chosen to block the access of product for all competitors.

I think it is a very foolish move on their part, and I think they are now regretting that they have done it. I think you are seeing a different attitude come forth in Mr. Mooney's testimony. I welcome it. I think it is necessary. I think the opportunity for the cable industry not to give up all of its position in the marketplace is still available to them.

They have two choices, in my opinion: reregulation or competition. I stand, as a businessman, ready to compete, ready to provide a choice in the marketplace. The issue is not just price; it is access to product.

Unfortunately, the material furnished to this committee sometimes is not completely accurate. Material furnished in the prepared testimony, for example, by NCTA, suggests that, for example, we have all this programming, it is all available to us, what is the problem? It is a price issue.

Well, I will give you a specific set of examples. Several weeks ago there was a hearing before the Senate Judiciary Committee, before the Anti-Trust Subcommittee. A representative of Time, Inc., HBO, Mr. Jerry Levin, said at the beginning of his testimony, Mr. Chairman, Senator Metzenbaum, we are happy to report that HBO is now available to Metro 10, the Cleveland wireless cable operator.

Fact: Metro 10 went out and secured a second franchise in the marketplace for the City of Cleveland. They had to do this through referendum because the city, in cooperation with the local cable operator, opposed them. Metro 10 was successful. They are now operating a second cable franchise. But they serve the entire Cleveland market.

So they have customers who live outside the city limits of Cleveland. But under the contract that has been proffered to them by

HBO, they are only allowed to serve the people who are inside the city limits of Cleveland.

So I challenge the statement of Mr. Levin to say that HBO has now granted a contract to the wireless cable operator. Not so. They have granted a contract to a second cable franchisee for the City of Cleveland. Mr. Thoreau is prohibited by contracted to sell the person on the other side of the street, outside the city limits.

Is that candor? I do not think it is candor. Is that proof? It is proof. But we are not here to try a case; we are here to establish a pattern that relates to the issue of concentration in media.

I am convinced that the cable operators and the programmers cannot help themselves. This has become an institutional problem. We need someone else to step in. We need some relief to allow the marketplace to function, or if it is not going to be a marketplace, then bring reregulation back into play.

I can cite many other examples, and I would be happy to do that in further material that we can furnish the committee, but I think the bottom line is the public, today, is now being hurt by increased prices, less service, and no choice. The public loves the programming, they love the product, but as Viacom said in its complaint—Viacom the cable operator, Viacom the programmer, in its complaint, when it is suing Time, Inc., under anti-trust laws, and I would like to read that to you, page 10 of their complaint; this is not a competitor, this is one of the brethren speaking—"Each cable operator is a monopolist in its local market or possesses a monopoly share approaching 100 percent." That is heresy.

If there is a monopoly, I challenge the cable operators to come forward and say they are good monopolists. I do not believe there is a good monopolist, especially when there is only one place to buy programming. Power corrupts, and cable has absolute power, and therefore their power is absolutely corruptible.

Now, what are the solutions? I did not come here just to complain; I am prepared to suggest a solution. When I was involved in the cable industry leadership, we were able to secure compulsory license. It was essential to get the cable industry started. Competitors to cable need a compulsory license on their programming, not forever, not in perpetuity, it can be sunsetted to allow competition to come into the market.

It is also not quite accurate to state, as cable states, they took all the risk. Not true. Time, Inc., before they became an owner of a cable system, took the risk. Cable operators bought the product on consignment. That is not risk taking. Cable operators took risk, but they did not take very much risk. They did not start taking initiative in this area until 1984. And with good reason. It became very apparent to them that the leverage in this business is in the programming, and you better control the programming. And that is what is taking place.

What you are seeing in vertical integration is not just for the sake of this programming that no one else will fund—I would like to ask Mr. Hendricks, who I think has a fabulous service, the Discovery service, how many of those people of the 50 companies he approached who turned him down were cable operators because they did not want to take the risk. They did not want to take the risk, so someone else took it first. And who was it that took it first?

Allen & Company and New York Life Insurance. They took the first risk. Cable operators came afterwards and now cable controls 56 percent of the channels.

And I have to say, in all fairness to them, they are not discriminating against us. They are not price-discriminating against us. They are making the product available. And we think the product is fabulous. But wireless consumers do not understand why they cannot get HBO.

Why won't ESPN sell to us? ESPN has said well, they have no problems; they are not vertically integrated. Leverage is what this is all about. ESPN went out a few years ago and did something that required them to invest a great deal of capital to secure the rights to the NFL Sunday night package. Inherent in securing those rights was the need for the cable operator to step up with additional funding. That cable operator leverage is now used on ESPN. Why? Because there is now a service called TNT.

Mr. Turner has TNT. Publicly stated when it was announced as a service, exclusively for the first franchisee in a marketplace. The second cable franchisee cannot get it; other competitors cannot get it. Guess what has happened. November of 1989, the NBA goes on TNT exclusively. Who is bidding against them? ESPN. ESPN better play itself very carefully, because the leverage is still in the hands of the cable operator. We are talking about power, and power in maximum terms.

The public is going to pay for this.

Mr. Mooney suggests that anybody who comes through this competition ought to have the same place on the field that they do; and they are paying a 5 percent fee to cities. Well, the wireless cable industry pays an additional sum of money to lease channels from educational institutions. They are called ITFS licenses. We lease up to 20 channels. We pay in excess of 5 percent for the lease of those channels. And we are contributing to education in the local marketplace. We are bringing education into the home, which cable is just getting around to doing now.

Cable is cleaning up its act today. And I admire what they are doing. But guess why they are doing it. It is because of the pressure from this body and from the states, from the attorneys general, and that is what it is going to take.

I can stand up here and tell you story after story, but the bottom line is the pressure has to be maintained, or they will go right back to abusing the power they have been granted.

My proposal is to give all new competitors a compulsory license. Let them get started and take it away when it is not necessary. Let competition be the solution, not reregulation. We do not need the government to regulate, we need the government to make sure that there is a marketplace. And prices will come down, quality will improve. We can demonstrate that in those markets where we operate. And we are coming, but it is taking time. And it is taking pressure from this group, and we appreciate it very much.

Thank you very much.

[The statement and questions and answers follow:]

STATEMENT OF

ROBERT L. SCHMIDT
PRESIDENT, WIRELESS CABLE ASSOCIATION

BEFORE THE
SENATE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION
COMMUNICATIONS SUBCOMMITTEE

JUNE 21, 1989

On behalf of the Wireless Cable Association, I thank the Subcommittee for the opportunity to testify today. The industry I represent is a relatively new entrant into the media and entertainment sector of the economy. For that reason, learning about our experience will be particularly useful to the Subcommittee as you study the effects of concentration of ownership on the marketplace.

Wireless Cable emerged in the mid-80's at the same time that the trend toward horizontal concentration and vertical integration in the media and entertainment sector began to accelerate. We therefore have first-hand knowledge of the effects of concentration on a new distribution technology and consequently its availability to consumers.

TREND TOWARD CONCENTRATION

Television gives Americans an almost unparalleled access to information and entertainment. All of our lives have been immeasurably enriched by this ready access to ideas and events.

The trend toward concentration of ownership in the media and entertainment sectors threatens this diversity of information and ideas. As the Subcommittee heard from the witnesses appearing last week, decisions concerning what the American people will read and see are increasingly influenced by "mega-firms" which control many different sources of information, including both the production and distribution of programming for television viewers.

The current play for Time, Inc. is only the most recent example of this phenomenon. Whether that company ultimately merges with Warner or is taken over by Paramount or another suitor remains to be seen. What is certain is that the resulting entity will have tremendous power over the flow of information and ideas into our homes.

Ironically, in the hearing called by the Antitrust Subcommittee of the House Judiciary Committee shortly after the announcement of the Time-Warner merger, Wireless Cable was the only industry that appeared to state its reservations over the deal. Given the Justice Department's swift approval of the transaction, there was a spell when Wireless Cable felt awfully lonely. But the concerns we raised then have since become widely-held, and have been repeated by such unlikely sources as Viacom in its antitrust suit against Time, and by TCI Chairman John Malone in his testimony before this Subcommittee last week. We're glad to be in such good company.

THE DANGERS OF CONCENTRATION

Concentration has particularly menacing effects in the segment of the media that I represent. Wireless Cable and other non-cable technologies are attempting to compete with corporate giants -- companies that not only own cable systems, but that also own or control much of the programming shown over those systems. What has this "cable concentration" brought to consumers? High prices. Poor service. And, increasingly, less -- not more -- diversity in programming.

1. High Prices: Cable rates rose 13.4% between March, 1988 and March, 1989. During that same period, the CPI increased by only 5%. During the past several months cable rate hikes seem to have abated somewhat. Whether this is a trend which will continue or a momentary aberration remains to be seen. What is clear is that the American consumer has already paid dearly for cable "deregulation."

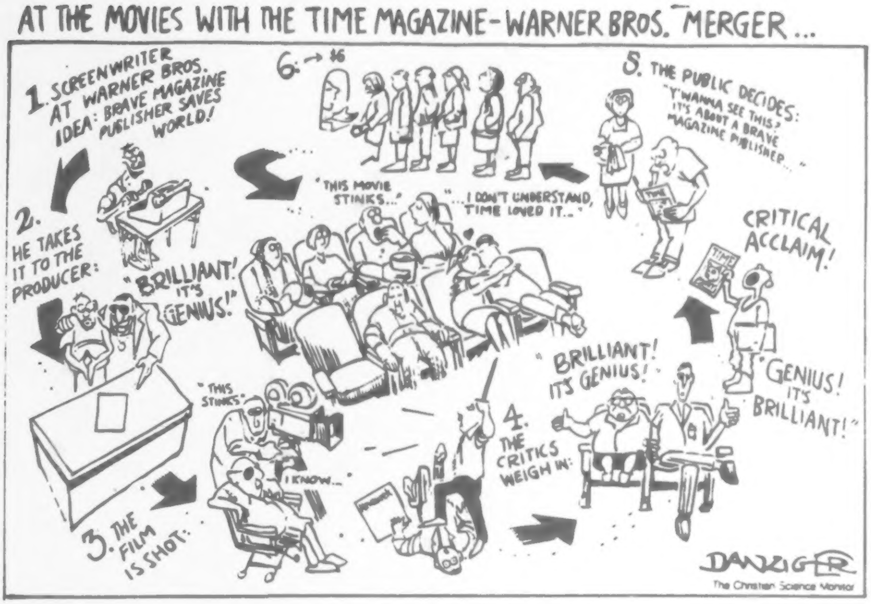
2. Poor Service: Cable is widely viewed as a monopoly at the local level. And like most monopolists, it has displayed a rather cavalier attitude toward serving its customers. As a result, 10 bills have already been introduced in state legislatures to codify the "Cable Subscriber's Bill of Rights," set standards for cable response to service requests, or otherwise improve cable service.

3. Reduced Diversity: We are witnessing increasingly a closed system, with one corporate entity controlling the

creation, production, promotion and distribution of information and entertainment programming. Wireless Cable has been suffering the ill effects of this closed system for some time: we have consistently been denied access to the premium programming that would enable us to compete head-to-head with the vertically-integrated concerns in the local markets.

Viacom, in its suit against Time, has now revealed that a closed system can hurt even a sizeable vertically-integrated competitor. Viacom charges that Time -- which owns HBO, the popular movie channel, as well as a string of cable systems -- has tied-up available cable outlets and locked-in the most desirable film products in order to protect HBO from competition in the market for pay television programming.

A Time-Warner merger risks pushing this "closed system" to an absurd extreme. Should that merger come to pass, or the related acquisition which Time now apparently proposes succeed, we would have a situation where Time-Warner films are reviewed by Time-Warner publications, licensed on an exclusive basis to HBO and Cinemax -- Time-Warner movie channels, and shown on the Time-Warner cable systems. But the Christian Science Monitor has already described this system much better than I:


AT THE MOVIES WITH THE TIME MAGAZINE-WARNER BROS. MERGER...
1. SCREENWRITER AT WARNER BROS. IDEA: BRAVE MAGAZINE PUBLISHER SAVES WORLD!
2. HE TAKES IT TO THE PRODUCER:
"BRILLIANT! IT'S GENIUS!"
3. THE FILM IS SHOT:
"THIS STINKS"
"I KNOW..."
4. THE CRITICS WEIGH IN:
"BRILLIANT! IT'S GENIUS!"
"GENIUS! IT'S BRILLIANT!"
CRITICAL ACCLAIM!
TIME
5. THE PUBLIC DECIDES: "Y'WANNA SEE THIS? IT'S ABOUT A BRAVE MAGAZINE PUBLISHER..."
6. → $6
"THIS MOVIE STINKS..."
"...I DON'T UNDERSTAND, TIME LOVED IT..."
DANZIGER
The Christian Science Monitor

Danzinger in The Christian Science Monitor c 1989 TCSPS (Reprinted with permission)

4. Reduced Output: A heavily-concentrated industry poses one additional threat. It is elementary economics that a monopolist will increase prices, reduce output or both.

Translating this behavior into the market for multi-channel programming services means among other things that the many areas of our country which have yet to be served by hard wire cable -- primarily rural areas and the inner cities -- probably never will be. There is little incentive for the multi-system cable operator that is able to reap monopoly profits from its existing service areas to incur the substantial capital costs entailed in building new systems.

BIGGER IS NOT NECESSARILY BETTER

Wireless Cable has testified many times over the past two years about the threats of concentration. By this time, we are well-versed in the arguments advanced by those who believe "bigger is better." We don't find those arguments to be persuasive; I don't believe this Subcommittee will either.

Myth No. 1: Cable took a risk.

A favorite theme of my coaxial cable competitors is that cable "took a risk" in developing programming. When the timing and pattern of cable investments in programming is examined, however, it becomes clear that very little "risk-taking" was involved.

First, cable was given an enormous boost when the Congress in the early 70's granted it a compulsory license over certain broadcast signals. This preference was intended to give a leg up to an infant industry, by guaranteeing it access to the programming needed to attract subscribers and by freeing it from the burden of negotiating licenses on a program-by-program basis.

Second, cable was in the right place at the right time to benefit from the advances in satellite technology in the mid-70's. When Time, Inc. launched HBO and Ted Turner turned WTBS into a superstation, cable was virtually the only multichannel distribution technology feasible under FCC rules. Wireless Cable, for example, did not really come into being until the mid-80's, as a result of a series of FCC decisions first issued in 1983. Cable, then, was the only technology going when the advances in satellites revolutionized television.

Third, cable, to put it bluntly, became a cash cow after the passage of the '84 Act and its implementation by the FCC. As long as three somewhat fuzzy broadcast signals were available in a community, cable has unfettered discretion to raise rates. And, as we have seen, cable lost no opportunity to exercise this discretion to raise rates at an unparalleled pace.

For the most part, cable's investments in programming have occurred since deregulation and the advent of unchecked monopoly profits. With the exception of C-SPAN and the programming of Viacom, which was historically a syndicator, cable did not begin investing in programming until after 1984.

Moreover, these investments were motivated by a desire to consolidate cable's monopoly position rather than by a desire to bring program diversity into the home of the American consumer. By controlling programming, you can control its availability to potential competitors. How else can you explain the fact that after big cable "bailed out" its friend Ted Turner, Mr. Turner decided to make his newest programming venture -- TNT -- available exclusively to cable?

Myth No. 2: Cable rate increases are due to higher programming costs.

Curiously, big cable often asserts -- as did TCI's John Malone last week before this Subcommittee -- that its tremendous price hikes of the last few years are the result of increased programming costs. Based on my reading of the trade press, I would have thought that it was the high cost of the cable systems being purchased by big cable -- reportedly at a cost of $2,000 - $2,500 per subscriber and more -- that was fueling the cable rate hikes.

I would have thought, too, that the supposed efficiencies of vertical integration would keep programming costs down. If programming costs are the reason that rates have soared, then cable ought not to charge itself so much.

Myth No. 3: Vertical integration is necessary to stave off foreign competition.

One of the primary arguments advanced by Time-Warner in support of their merger was that it was necessary in order to fend off foreign competitors. If that is truly the case, I would submit that Representative Markey has come up with a solution: he proposes, in H.R. 2643, the "Cable Television Foreign Ownership Act of 1989," to restrict foreign ownership of cable, Wireless Cable, and other television distribution technologies. Representative Markey's approach seems a more reasonable response than the creation of an entity which would stifle not only foreign competitors, but domestic ones as well.

Myth No. 4: Vertical integration benefits consumers.

My friends at the NCTA recently attempted to cloak their practices with the mantle of academia by introducing into the debate a new "study" of vertical integration. The "findings" of this NCTA commissioned study were hardly a surprise. It was authored by an economist trained at the University of Chicago. Like Robert Bork, Richard Posner, and other disciples of the so-called Chicago school of economic theory, the NCTA's Dr. Benjamin Klein has apparently never seen a vertically-integrated corporation he didn't like.

I'm not an economist, I'm a businessman. While the vertical integration of companies which have monopoly power does not seem to trouble Dr. Klein, it troubles me, and I believe it should trouble this Subcommittee.

On a theoretical basis, I would agree that vertical integration can produce efficiencies. But as Dr. Klein states, theories do not tell us much without "appropriate real world evidence from the case at hand." Page 27. And the real world evidence disputes many of Dr. Klein's findings. For example, to name just a few:

> "[N]o MSO controls a sufficient number of cable systems to be able to foreclose entry into cable programming." Page 28.

This is precisely the charge that Viacom has leveled against Time, Inc. As a result of Time, Inc.'s stranglehold over important cable franchises such as the one in Manhattan and its alleged coercion of non-affiliated cable systems, Viacom claims that its ability to sell its own pay programming, Showtime and The Movie Channel, has been severely hampered.

> "Since MSOs . . . typically are not in direct competition with one another, an MSO would have nothing to gain by preventing a network that it had an ownership interest in from being carried by other cable operators." Page 27.

Again, Dr. Klein should have interviewed Viacom before reaching this conclusion. Viacom charges that Time, Inc. has been reluctant to sell HBO to Viacom systems, even when those systems do not compete with a Time cable operation.

Moreover, even Dr. Klein admits that if an MSO had sufficient market power, it could "presumably" use this power to deny competitors access to programming. Page 49. The real world evidence, as demonstrated by the Viacom suit and Wireless Cable's experience, suggests that some MSOs do have sufficent market power to deny competitors access to programming, and that they do, in fact, deny competitors access.

> "Vertical integration results in increased program choice for consumers." Page 45.

We would contend that vertical integration too often results in less, not more, choice for consumers. And I believe many New York Yankee fans would agree. Those consumers can't see their favorite team because Madison Square Garden (MSG), the programmer that has rights to the games, is not carried by their local vertically-integrated cable system. Many believe that the cable system is refusing to carry MSG because it does not want competition for its own premium sports channel.

Dr. Klein should also have interviewed Ted Turner before leaping to this conclusion. If he had, he would have learned that Mr. Turner has just announced that, beginning this coming November, the NBA games carried on TNT will be available only to the original cable franchisee in any given franchise area. Not only will these games be cable-exclusive, as is all TNT programming, but they are restricted to a select group within the cable club. Such practices can hardly be found to increase programming diversity.

> "Exclusivity is not necessarily anti-competitive." Page 50.

We agree. But we believe exclusivity is anticompetitive when it is not obtained fairly, and when it is based on considerations other than selling to the highest bidder.

For example, we challenge Dr. Klein to justify in competitive terms Ted Turner's decision to make TNT cable-exclusive. Or ESPN's decision to sell its Sunday NFL game package exclusively to cable systems. Such cable-only policies preclude Wireless Cable from even bidding for the programming. If that's not anticompetitive, I don't know what is. What's worse, cable-exclusive arrangements make many consumers second class citizens if they live in areas not yet wired for coaxial cable.

> "[T]he evidence clearly shows that many vertically integrated program networks make their products available to MMDS." Page 54.

There they go again. If programming were indeed _generally_ available to Wireless Cable, NCTA would not have to spend its time and resources on surveying Wireless Cable systems across the country to determine what programming each carries. Wireless Cable systems that have rights to premium programming such as HBO and Showtime are still the exception rather than the rule.

Allow me to give you a few concrete examples of Wireless Cable's so-called access to programming.

1. Cleveland's MetroTEN, a Wireless Cable system which was also awarded a cable franchise in a city-wide referendum last November, tried for over five years to obtain the right to carry HBO. Finally, on the eve of Senator Metzenbaum's Antitrust Subcommittee's hearings on the issue, HBO agreed to sell to MetroTEN. But that system only obtained the rights to HBO in its capacity as a _cable franchisee_ within the Cleveland city limits. As a result, HBO is available only to MetroTEN customers within its cable franchise area not, for example, out in the Cleveland suburbs. In some neighborhoods, if you're a MetroTEN customer who happens to live on the wrong side of the street, you're plain out of luck.

2. Even when programming is made available to Wireless Cable, it is under discriminatory terms and conditions. Again, take Cleveland's MetroTEN as an example.

After protracted negotiations, last month SportsChannel America, a sports network owned by the MSO Cablevision, agreed to sell to MetroTEN. MetroTEN could only obtain SportsChannel America, however, by agreeing to carry it as a basic service. MetroTEN's cable competitor, in contrast, is able to place that channel on a pay tier. As a result, SportsChannel America ends up costing MetroTEN a good deal more than it does its cable competitor.

3. Our problems with access are not limited to programming owned by vertically-integrated companies because their influence over the so-called independents is enormous. Skyview, the Madison, Wisconsin Wireless Cable operator, until recently brought ESPN to its subscribers. It did, that is, until ESPN discovered that Skyview was a Wireless, rather than hard wire, cable operator. When ESPN found that out, it pulled the plug on Skyview, even though Skyview had regularly and consistently paid for ESPN's programming. We can conceive of no reason why ESPN would want to terminate its relationship with Skyview, unless it was responding to pressure from its MSO customers.

These are only a few of the access problems that have plagued Wireless Cable. The fact of the matter is that this industry simply does not enjoy the access to programming which it needs if it is to compete for subscribers in the marketplace.

PROPOSED SOLUTION -- COMPULSORY LICENSE FOR NONCABLE TECHNOLOGIES

It is clear that congressional action is needed to counter the dangers of increased concentration. The Justice Department's hasty approval of the Time-Warner deal shows that this administration, like the last, has yet to see a merger it doesn't like. And the FCC seems to have a split personality when it comes to cable competition. On the one hand, it says that three broadcast signals offer "effective competition" to local cable monopolies. On the other, it concludes that maybe those three signals aren't enough, and what we really need is for the telephone companies to enter the market.

I urge the Congress to take charge of this situation by granting to Wireless Cable and other noncable technologies the step-up it provided to cable in the early 70's, namely, a compulsory license to the programming needed to compete in today's market. Such a license would enable today's fledgling technologies to enter the market in a meaningful way and provide consumers with a choice, just as a similar license aided cable in its infancy.*/

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*/ Even the NCTA's Dr. Klein concedes that today's market conditions preclude Wireless Cable and other new technologies from producing their own programming. Page 49, note 49.

Unlike the compulsory license which cable currently enjoys, however, I would not advocate that Wireless Cable and other developing technologies be granted such rights on an open-ended basis. Rather, I would propose that such a license be time-limited; that it "sunset" when the realities of the market prove that it is no longer needed to enable us to compete.

Congress aided and abetted the creation of the local cable monopoly, first through the grant of the compulsory license and second through deregulation in 1984. I believe the compulsory license which I propose would be a reasonable means of countering this monopoly power and providing consumers with a choice.

CONCLUSION

NCTA President James Mooney suggested in a recent interview with CableVision (5/22/89, p. 54) that the current congressional scrutiny of cable is nothing to worry about -- this is just the time of year when Congress holds hearings. I for one challenge this Subcommittee to stir Mr. Mooney and the industry he represents from their complacency.

Congress has but two choices when it comes to cable: reregulate the industry or adopt other measures to stimulate competition. Wireless Cable favors competition over reregulation.

There is an urgent need for increased competition in the market for subscription television services. Whether Congress stimulates competition by means of the compulsory license which I proposed this morning, or acts on any of the over a dozen bills currently pending before it, something should be done to infuse new life into the marketplace. Television plays too significant a role in our daily lives to permit it to be controlled by a few corporate behemoths. The trend toward increased concentration in the industry must be checked.

POSTHEARING QUESTIONS OF SENATOR INOUYE

Question. Mr. Schmidt, in how many cities can all of the cable subscribers choose between a cable operator and a wireless service?

Mr. Schmidt, do your members have access to all cable programming services? Why not?

Answer. As of June 1st, approximately 24 wireless systems are up and operating in the United States. It is anticipated that an additional 6-8 systems will be on-line by the end of this calendar year.

As I stated in my prepared remarks and in response to questions from Committee members, over the past several months, primarily from Congressional pressure, many cable programmers have agreed to make their product available to wireless cable operators. We are still having a great deal of difficulty in securing HBO, TNT and ESPN to name 3 specific services. HBO and ESPN state internal business reasons why they are not making their product available to wireless cable operators and TNT has a stated policy not to sell to anyone but the first cable franchisee in a given market.

Senator **INOUYE**. Thank you very much, Mr. Schmidt.

May I now call on Mr. Padden, the President of the Association of Independent Television Stations.

STATEMENT OF PRESTON PADDEN, PRESIDENT, ASSOCIATION OF INDEPENDENT TELEVISION STATIONS, INC.

Mr. **PADDEN**. Thank you very much, Mr. Chairman.

We sincerely appreciate you and your staff organizing these hearings. We think they are very, very important and we appreciate the opportunity to appear.

There are, at present, over 300 independent television stations across the country. And we now account for about 25 percent of all viewing. And I think that indicates that the cable industry does not have the corner on the market for bringing diversity to the American people. We play a substantial role in that as well.

But there is an important difference between the service we provide the consumers and the service cable provides. And that is that our service is free. And it is free to all of the citizens in the communities where we operate, the rich and the poor, and those that have cable and those who do not. We provide them with free news comparable to the primetime news on channel 5 here in Washington; and free sports. I am sure the chairman is familiar with all of the University of Hawaii coverage on channel 13 in Honolulu; absolutely free to all the residents.

We provide them with free entertainment. You know, the cable industry is now talking about pay comedy channels. Now they are going to try and make the American people pay to laugh. Well, we do not make them pay to laugh. And we provide free children's programming. Again, available equally and free to all of the children in the communities where we operate.

Now, I am going to try to avoid the, sort of, end-of-the-world syndrome here this morning of people coming before you and telling you that if you do not do something the sky is going to fall. But we are genuinely concerned about the future of the free television medium in this country.

And the problem is that we are trying to provide a free service at the highest quality in a market in which access to about half of all television homes is now controlled by a monopoly cable conduit, a gatekeeper. And that gatekeeper is vertically integrated into the ownership of services that compete with us for program rights, for viewers' eyeballs, and for advertisers' dollars.

And all across the country the unregulated gatekeeper has responded by dropping stations from their systems or by shifting our signals to channels that do not get through to all of the television sets hooked to the cable; the underlying objective being manipulation of the advertising market.

And Mr. Chairman, I heard your reference to the other hearing, the military hearing this morning, and I was thinking maybe we could combine them, because the effect on us has been very similar to ICBM's, and perhaps we could put them together.

When they do carry our signals, they sell our programming to consumers and they keep all the money. And they use that money to help fund the purchase of program rights to take them off of free television and put them on pay television. And we honestly believe that unless the Congress acts to change this environment, what we are going to see is the slow erosion of free television into oblivion in this country.

We have prepared this chart to my right to try and summarize some of the problems we see in the marketplace and some of the remedies that we think might be available to you.

Starting with the column on your far left, the environment in which we have now. And one of the most fundamental points is the cable industry's continued free use of broadcast television product. We have no "must carry." And as I listened to Mr. Johnson earlier, I could not help but think about the effect on some of the new minority independent stations that are just coming on line as a result of the FCC's minority ownership policies, who are being stonewalled by cable systems across the country.

There is no restriction on horizontal concentration or vertical integration. There is no competition; you have heard from others about that. Local governments are no longer able to cope with the situation. And there is no rate regulation.

The result of all of this: we see sports events moving from free television to pay television all across the country. There is now an

NFL package that has gone from free television to pay television. It includes the Pro Bowl. You cannot see the Pro Bowl any more if you do not have cable television. A baseball package just moved to ESPN.

And one of the worst provisions of this package is, if you are a local station who has negotiated a contract with a local baseball team to provide free broadcast of their games, the cable network got exclusivity on Wednesday nights, so you are prohibited from exercising your contractual right to do a free broadcast of any baseball on Wednesday night, so it does not interfere with the pay telecast. They do not want people to have a free alternative to their pay telecast.

In New York, our member station has broadcast 100 Yankee games every year free of charge to all the people in New York for 40 years. They are now down to about 50 games, and starting in 1991, they will have no games. They will all be on a cable channel.

Across the country we are seeing regional sports channels popping up like daisies. Dr. Malone tried to paint himself as the victim of these channels. That is very odd to me, because his company owns six of them. And they are absolutely siphoning sporting events from free television to pay television.

And it is not just the professional events. We have stations who are being notified that their contracts for collegiate sports in the PAC 10, the University of Oregon, the University of Washington notifying stations no longer will they have the games to telecast for free because they are going to pay cable channels.

And one specific suggestion we would offer to you and your subcommittee today is that you might want to do your own investigation of what events these regional pay channels are in fact offering, and whether they previously were available to consumers for free.

We also see underlying this manipulation of the local advertising market. You have heard about the channel shifting going on. Mr. Mooney tries to make it sound like it is very reasonable to put the local stations on their over-the-air channel.

I would like to read to you just an excerpt from a letter that Jones Intercable sent to their advertisers in Jones' own words explaining the reason for these channel shifts.

They said on March 1—this was in 1987—Jones Intercable made changes that "greatly enhanced the value of advertising placed with us. On that we realigned our channels bringing four of the five channels on which we insert advertising down to channel positions between 2 and 13."

Needless to say the local broadcasters, who previously were in those channel positions, got booted up to Siberia.

Jones goes on to say to their advertisers "studies performed on viewership patterns on channels 2 through 13 show that they are viewed 30 percent more often than higher channel positions. This means the advertiser's exposure to area consumers increased greatly."

That is the reason for these channel shifts. It is manipulation of the advertising market by a vertically integrated monopoly conduit, and at the moment there is just absolutely no recourse that we have in the face of these shifts.

We have heard a lot about ownership concentration. We know it is a monopoly. Dr. Malone testified the other day that consumers vote for cable every month, so they must like it.

I think that is like saying that people that get stuck in the Holland Tunnel every day commuting to New York are voting for it. They must like it or they would not be there.

The reality for both the people in the tunnel and cable subscribers is they are there because they do not have any other alternative. There is no other access for them to television.

With respect to vertical integration I would agree with Mr. Hanks. Vertical integration, per se, is not the problem. It is when you have a monopoly exhibitor vertically integrating into programming that causes the problem.

With respect to the Klein study you have heard a lot about, there is absolutely nothing in that study anywhere about the effect on broadcasters. And I think the results are largely premised on the fact that a lot of older cable services that became established before vertical integration got going that were included in that survey, and if you look just at newer cable services, you would find that the reality is today that you cannot start a new cable program service without system operator equity being introduced.

There are lots of examples of the bad effects of this vertical integration across the country. You have heard a little bit from Mr. Schmidt, quotes from Viacom's antitrust lawsuit.

Ted Turner himself at one point was not vertically integrated, faced competition from a vertically integrated operator, and he went to federal court and made the same kinds of allegations.

Some of the remedies we would suggest to the subcommittee to consider, the very first would be to separate the ownership of the cable conduit from the ownership of the content going through it. That was the principal recommendation of a White House report in 1974.

And if we had followed that, I do not think we would be having this hearing here today.

We have got to do something to assure local station access and stop the channel shifting. Senator DeConcini has introduced S.177 that would have accomplished that. Senator Lieberman has introduced S.905 that would accomplish the same result.

We hope that Congress will do something to stop the siphoning of sports events from free television to pay television, and there are two ways you could go about that.

You could try to directly legislate to stop it by legislative fiat.

The other, which we have labeled up here "Fair Payment for all services and signals"—the other way of getting at this, assuring the survival of free television, would be to require the cable operator to share this revenue stream equally with the vertically integrated service they own and the broadcast services that they carry and exploit for which they are currently not paying one red cent.

You know, Dr. Malone sat here and talked about how much his program costs were going up. Well, given his vertical integration, he is paying himself.

So I think what he was saying is that he is charging himself a lot of money for these program services. He is not paying a nickel for the broadcast product.

And finally, we would urge you to look at the option of telephone company competition. We have a lot of concerns and trepidation about making that recommendation.

We certainly are talking only about telephone companies operating purely as common carriers without vertical integration in the programming, I think cable has shown us we have enough problem with that, but we think it is an option that we need to look at.

I would like to briefly add one thing about the broadcast issues you are going to be discussing tomorrow, and that is we strongly support the retention of the network cable cross-ownership rule and the financial interest and syndication rule.

And in my testimony on page 31 there is a quote from Mr. Nick Nicholas at Time, Inc., in which he predicts that the Congress and the FCC will permit both of these rules to be repealed. And at that point we would have massive mega mergers of studios, networks and cable companies. And I think we have enough mega merger going on in this industry right now without removing the few baffle stops that are left to keep some balance of power out there in the marketplace.

Thank you very much.

[The statement and questions and answers follow:]

STATEMENT OF PRESTON R. PADDEN, PRESIDENT, ASSOCIATION OF INDEPENDENT TELEVISION STATIONS, INC.

Thank you Mr. Chairman. My name is Preston Padden and I am President of the Association of Independent Television Stations. The American people now enjoy service from over 300 local Independent television stations -- stations not affiliated with the ABC, CBS or NBC television networks. The locally based information and entertainment services provided by our stations are available free-of-charge, without discrimination to all viewers -- rich and poor, cabled and uncabled.

For example, our stations provide free news and information services, including such prime time newscasts as those provided by Channel 5 here in Washington, Channel 56 in Boston, Channel 12 in Portland and many other areas across the country. Our stations also provide the American people with free coverage of sporting events including popular professional, collegiate and high school contests. I am sure that the Chairman is familiar with the extensive free coverage of University of Hawaii baseball, basketball, volleyball and football on Channel 13 in Honolulu. Free entertainment, including motion pictures, situation comedies and action adventure programs are another service of the Independent stations. Unlike the new pay TV comedy channels proposed by Viacom and Time, Inc., we don't charge the American people to laugh. Last, but of great societal importance, is the free children's programming we make available, without discrimination, to all young viewers.

I.

Introduction

We commend you Mr. Chairman, Senator Packwood, the other members of the Subcommittee and your outstanding professional staff for holding these vital and comprehensive hearings.

A. Cable Issues

I am here today testifying about cable ownership issues because we have very real problems that warrant your serious attention and legislative action. The monopoly character of the cable industry, its vertical integration into programming and an outdated regulatory and copyright regime, present a clear threat to our system of free broadcasting -- particularly the Independent stations that are the most commercially vulnerable segment of that system. Unless Congress acts now, cable pay television services will largely supplant our free broadcast system.

The unregulated, vertically integrated cable monopoly has refused to carry new local stations, has shifted established stations to channel positions that are not viewable on many cable-connected sets and has begun to siphon popular program events, particularly sports, from Free TV to pay TV. All the while, the cable industry continues to feed off of the very free broadcast system that it now seeks to undermine.

The policy objectives of diversity and competition, of access and choice, have been cornerstones of our national communications policy. In the 1940's and 50's the government acted to curb vertical integration between motion picture studios and neighborhood theaters.

In the 1970's the Justice Department and the FCC took action to curb vertical integration by the three dominant national television networks. Today, we ask you to act decisively to curb vertical integration by the most egregious bottleneck in the history of communication -- the monopoly cable industry.

I urge you not to be lulled into complacency by easy and reassuring rhetoric from cable witnesses. The incontrovertible facts of cable's actual marketplace behavior belie any theoretical treatise purporting to prove that all is well. For example several years ago, NBC attempted to launch a general cable news service to provide competition to CNN and to provide viewers with a choice. However, the cable gatekeepers said no. Following NBC's decisive rejection by TCI, the largest MSO, it was announced that TCI had received an equity position in Turner Broadcasting System, owner of CNN. That probably was not just a coincidence.

More recently, NBC launched a new cable service limited to consumer and business news. Many cable MSO's are now vertically integrated into the ownership of Turner Broadcasting System. Some MSO owners of Turner's CNN agreed to carry NBC's new service only upon receiving written assurances that NBC would not expand its consumer and business news service into a general news service in competition with CNN.

I invite any of the cable witnesses appearing before you to provide a pro-competitive, pro-consumer explanation for why NBC was required to promise not to provide the American people with a competitive source of cable news. More specifically, before you accept TCI's assertion that it is merely a benign "purchasing agent" for its subscribers, ask how TCI concluded that its subscribers did not want a choice of cable news services.

We also urge you to reject the TCI argument that the virtue of cable is evident in the fact that consumers "vote" for cable every month when they pay their bill. Given the monopoly character of cable, these 'votes' are equivalent to the 'votes' received by the Communist Party in pre-Perestroika Russia.

B. Broadcast Issues

With regard to broadcast issues, we urge you to support retention of the Network/Cable Crossownership Rule and the Network Financial Interest and Syndication Rules. These rules are the only safeguards against a complete monopolistic consolidation of the television industry. Repeal of these rules would lead to megamergers of network-studio-broadcast-cable interests destroying the current balance of power in the marketplace and depriving consumers of the benefits of competition and diversity. Repeal would also permit the three national television networks to engage in discrimination against Independent stations.

II.

Congress Must Re-regulate The Cable Industry

A. Cable Television Systems Have Developed As Local Monopolies

Any analysis of cable ownership issues must begin with the fact that cable systems have developed as local monopolies. The premise of the 1984 Act was that cable would develop in a competitive environment. Many legislators may have relied upon the promise of the cable industry that:

> "A consumer will have a couple of choices of cable companies. There will be two cable wires running down the street. 1/

Other legislators likely relied on the anticipation that cable would face competition from emerging new technologies such as direct broadcast satellites.

With the 20/20 vision of hindsight, it is now clear that there is no competition -- no head to head cable competition, and no effective competition from other media. Ninety nine-plus per cent of all cable subscribers are served by a single monopoly cable system.2/ Direct broadcast satellites have not developed in this country and no other technology has gained a foothold in the marketplace. 3/

1/ Thomas Wheeler, President of the National Cable Television Association at Hearings before the Subcommittee on Communications of the Committee on Commerce, Science and Transportation, United States Senate, 98th Congress, First Session (February 16-17, 1983), pages 126-167.

2/ Traditional anti-trust analysis, including the Herfindahl-Hirschman Index, are simply inapplicable to industries such as cable where consumers have a choice of exactly one service provider.

3/ While MMDS and DBS have the potential of being competitive services, to date this has not materialized. From past testimony, it appears that MMDS operators have been unable to obtain rights to popular satellite delivered services, or have been offered terms far more expensive and onerous than those given to cable operators. The newer technology -- DBS -- seems to be the target of the cable industry in an effort to co-op the business. A consortium of cable's biggest MSO's is negotiating to buy or lease the entire capacity of GE's K-1 satellite, the only potential DBS vehicle likely to be available for the next five years. See Satellite Business News, June 14, 1989 at p.1.

In candid statements in industry trade publications, cable leaders frequently acknowledge the monopoly character of their distribution systems. [4] No less an authority than R. E. (Ted) Turner has averred in a Federal Court complaint that cable operators exercise "monopoly power" over "essential facilities". [5] Viacom, the fourth largest MSO, has also commenced litigation in which it describes cable -- repeatedly -- as a "monopoly". [6]

The FCC, in one of its least distinguished decisions, concluded that the presence of three grade B over-the-air broadcast television signals constituted "effective competition" for basic cable. [7] The Commission's definitional standard is now widely regarded as being devoid of intellectual, econometric or public policy merit.

4/ "I'm basically a monopolist. I don't like to admit that in public forums, but I want to be the only guy in that territory to serve cable television services there or sell services to some other people. I think they shouldn't be denied those services, but I want to be that link...." Marc Nathanson, CEO, Falcon Cable, Cablevision, January 18, 1988 at 36.

5/ Cable News Network Inc. v. Satellite News Channels, Civil Action File No. C83-430A, U.S. District Court, N.D.Ga., Complaint filed Mar. 3, 1983.

6/ Viacom Int'l, Inc. et al v. Time, Inc. et al, Civil Action File No. 89-3139, U. S. District Court, S.D.N.Y., Complaint Filed May 8, 1989.

7/ INTV's interest in the definition of "effective competition" is unrelated to the issue of cable rate regulation. Rather, INTV's interest stems from the impact on carriage and channel shifting disputes of misdefining the circumstances under which cable system are deemed to be subject to "effective competition." For example, the channel shifting that many Independent stations have suffered, has frequently occurred in conjunction with retiering. Section 625(d) of the Cable Act prohibits retiering by cable systems that do not face "effective competition".

It has been publicly disavowed by two of the three sitting FCC Commissioners. Even the Department of Justice, which has not exactly been a beehive of enforcement activity with regard to cable industry developments, sharply disagrees with the FCC's "effective competition" decision. In its comments to the FCC, Justice concluded that broadcast signals are not a good substitute for basic cable service. [8/] Justice also concluded that so-called new technologies could not be relied upon, at this point in time, to provide effective competition to cable. (*Id*. at 19).

According to the Department of Justice, the most fundamental flaw in the Commission's definitional approach is that it ignores cable market power derived from the carriage of satellite delivered cable networks and other non-local programming sources. (*Id*. at 28 and 30). According to Justice, focusing solely on broadcast stations does not "reflect the economic realities of basic cable service." (*Id*. at 29). The Department specifically found that "where the cable system offers a relatively large number of basic programming services not otherwise available in the market, the cable system is more likely not subject to effective competition." (*Id*. at 35). Today, most cable systems offer just such an array of services not otherwise available to most consumers.

About a year ago, two distinguished economics professors -- Janusz Ordover of New York University and Yale Braunstein of the

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[8/] Comments of The United States Department of Justice, MM Docket No. 84-1296 at pg. 18.

University of California at Berkeley -- wrote a paper dealing with the issue of when cable was really subject to effective competition.[9] Their study concluded that "tier meltdown" in the cable industry, an enlargement of the average number of channels, increased horizontal concentration of ownership and increased vertical integration into programming had all contributed to rendering the Commission's definitional standard highly suspect. Professors Ordover and Braunstein specifically found that broadcast television "can't compare" to modern broadband cable from an anti-trust competitive standpoint, and that cable constitutes a "distinct product." [10]

In sum, analysis of cable ownership issues must take into account the fact that cable has developed as a monopoly that is not subject to effective competition. Neither consumers nor broadcasters have marketplace substitutes to which they may turn in the face of anti-competitive actions by local cable monopolists.

B. Horizontal Concentration and Vertical Integration In The Monopoly Cable Industry Are Undermining The Goals of Diversity And Competition

Horizontal concentration of cable ownership has proceeded at a furious pace since the adoption of the 1984 Act. One single cable company, TCI, now controls access to television for more than 11 million Americans. The revenues collected at TCI's "gatekeeper"

9/ "Does Cable Television Really Face Effective Competition?", Janusz A. Ordover and Yale M. Braunstein, appended hereto as Attachment No. 1.

10/ *Id*. at 14.

toll booth in 1988 totaled a staggering $2.282 Billion. Two large multi-system owners, United Cable and United Artists Cablevision completed a merger just last month. The merged company is the third largest MSO and is controlled by TCI, the largest MSO. The Time/Warner merger, if consumated, would represent a marriage of the second and the fifth largest MSOs. Traditional indices of concentration, such as the Justice Department's Herfindahl-Hirschman Index, are inapplicable to cable. Since subscribers have a choice of exactly one (1) cable operator, the presence of other operators in the industry does not present real competitive alternatives for consumers. Stated another way, cable operators to whom a consumer has no access cannot act as a constraint upon the pricing and practices of the one operator to which the consumer does have access.

Of even greater concern than horizontal concentration is cable vertical integration. Integration by a monopoly exhibitor into an otherwise competitive programming market is cause for genuine alarm. According to the Wall Street Journal (May 4, 1988 at 29), "Cable system owners have taken minority equity interest in virtually every new programing channel that has started in the past two years." As a practical matter, it is almost impossible in the present environment to start a new cable program service without surrendering equity to the owners of the monopoly cable conduits.

For example, to launch its new business news service NBC reportedly paid TCI an estimated $20 Million to buy or lease Tempo Television -- a cable service whose apparent assets would appear to have been negligible. That transaction has all the appearances of the payment of tribute for access through TCI's concentrated monopoly subscriber base.

Worse yet, to pacify the cable operator owners of CNN, NBC was required to promise, in carriage agreements, not to broaden its service from consumer and business news into general news. (Multichannel News, December 12, 1988 at 50.) It seems inconsistent that an industry so fond of invoking the protection of the First Amendment would make NBC promise not to provide subscribers with an alternative source of general news. Simply stated, there is no pro-competitive explanation for such a requirement.

Because of the trend toward vertical integration, cable operators now have a clear vested interest in the competitive success of some of the programming services seeking access through their conduit. You don't need a Ph.D. in Economics to figure out that the guy who controls a monopoly conduit is in a unique position to control the flow of programming traffic to the advantage of the program services in which he has an equity investment and/or in which he is selling advertising availabilities, and to the disadvantage of those services, including local Independent broadcasting stations, in which he does not have an equity position. Not surprisingly, after the fall of the must-carry rules, one MSO, United Cable, dubbed as its new "must-carries - services in which United has an equity position". (Multichannel News, November 3, 1986 at 39.)

As our laws stand today, a telephone company is prohibited from owning a cable system for fear that it might "favor[ing] its own or affiliated interest as against nonaffiliated interests...." [Section 214 Certificates, 21 FCC 2d 307 (1970)]. And, a broadcast station is prohibited from owning a cable system to prevent it from gaining a "competitive advantage" over other stations. [CATV, 23 FCC 2d 816, 820 (1970)]. But, cable operators are permitted to integrate vertically into programming, and to use that integration to gain a competitive advantage over others seeking access through their monopoly conduit.

The broadcast network/cable crossownership rule provides a particularly apt analogy here. This rule, which continues to enjoy the support of many Congressional leaders, prevents a broadcast network from manipulating the traffic on cable systems to the advantage of its own affiliates and programming. The same prohibition should apply to the cable networks for the same reasons.

The anti-competitive potential inherent in common ownership of the cable conduit and program services was clearly recognized in the 1974 "Cable Report to the President" by the Cabinet Committee on Cable Communications. A copy of that report is appended as Attachment No. 2 to my testimony. With startling prescience, The Cabinet Committee (comprised of Elliot Richardson, Leonard Garment, Herb Klein, Peter Peterson, George Romney and Clay Whitehead) expressed its competitive concerns in the following terms:

> "Cable's multi-channel technology, together with the economic imperatives of a medium that is a natural monopoly, could lead to an even greater concentration of power than exists in broadcast television. When a single cable operator has the power to control the programming and information content of all the channels on his system, his monopoly power over the cable medium of expression is nearly absolute."

The solution chosen by the Cabinet Committee was a recommended separations policy. The Committee described its proposal as follows,

> "We recommend adoption of a policy that would separate the ownership and control of cable distribution facilities, or the means of communications, from the ownership and control of the programming or other information services carried on the cable channels."

Somehow, the thrust of this compelling report was lost in the rush to pass the Cable Policy Act of 1984. As a result, local broadcasters and consumers now face a vertically integrated monopoly cable industry with a clear incentive to engage in anti-competitive behavior.

The resulting list of horror stories grows almost daily. Jones Intercable has banished USA Network, one of the most popular non-operator owned program services, from its cable systems. Jones replaced USA with Turner Network Television, TNT, a cable program service in which Jones holds an equity interest.

In New York, Cablevision's SportsChannel lost a bidding war with MSG Cable Network for rights to telecast New York Yankee games. Cablevision responded by banishing MSG from the Cablevision-owned systems. As a result, hundreds of thousands of consumers are deprived of the opportunity to watch the Yankees, the Rangers and the Knicks.

Another example of the vertical integration problem can be seen in Manhattan where 50 cable consumers were forced to resort to private litigation under the anti-trust laws to gain access to cable services other than those owned by their local monopoly cable system owner. [New York Citizens Committee On Cable TV v. Manhattan Cable TV, Inc., 651 F.Supp. 802 (D.C.N.Y. 1986)]. Plainly it does not serve the Cable Act's goal of competition and diversity if consumers are unable to gain access to program services they wish to view because those services are deemed to be competitive with other services owned by their local monopoly cable operators.

Viacom's Showtime and The Movie Channel are the pay services most directly competitive with Time, Inc.'s HBO and Cinemax. Gaining access to Showtime was frequently cited as an objective of the New York Citizens Committee in the litigation described above. (See, The Village Voice, January 13, 1986, at 45.) After Time, Inc. lost several preliminary skirmishes, the case was settled on terms that required Time to begin carrying pay services that it does not own. However, instead of adding Showtime to its Manhattan system, Time added services that are not directly competitive with HBO such as Bravo, a cultural service.

Because the Citizens litigation did not succeed in making Showtime available in Manhattan, Viacom has now been forced to commence a second anti-trust action to gain access to, and reasonable treatment on, Time, Inc. owned cable systems. In its complaint, Viacom makes the following assertions of fact:

> "Each cable operator is a monopolist in its local market". (Complaint at 10.)

> "To disadvantage pay services which compete with defendent HBO, Inc. and maintain and entrench HBO, Inc.'s monopoly power, defendent ATC has refused access on its cable systems to competing pay services, notably Showtime and The Movie Channel or has provided access only on a discriminatory basis, injuring plaintiff SNI and consumers". (Id. at 15.)

> "Even in those local markets where ATC carries Showtime and/or The Movie Channel, defendant Time, acting through defendant ATC, treats Showtime and The Movie Channel in a discriminatory manner and *disadvantages them with regard to channel position, in promotion and marketing, and otherwise*". (*Id*. at 18.) (Emphasis added)

Viacom is not the only cable industry "insider" to make such allegations in a sworn complaint. Turner Broadcasting Co. operates four program services, (CNN, Headline News, WTBS and TNT), and is the leading supplier of program services to the cable industry. In perhaps the most dramatic example of cable vertical integration, a consortium of the nation's largest cable system operators purchased approximately half of Turner's equity. 11/ Thus, Turner presently represents one of the most striking examples of cable system operators integrating vertically back into the ownership of program service suppliers. However, there was a time when Turner was an independent supplier to the cable industry not vertically integrated with cable

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11/ Other companies, including broadcasting companies, were fully prepared to contribute equity to the Turner organization. The fact that it was cable system operators who did so, seems more a product of the cable industry's desire to control the marketing of Turner's program services, rather than any paucity of their prospective investors.

Cable advocates frequently suggest that the growth of cable program services would not have been possible without operator equity. The Turner history refutes that contention. Moreover, there is evidence that offers of equity investments by program production interests have been rejected. Testimony of Mr. Jack Valenti, President, Motion Picture Association of America, Cable Television: Hearings, supra at 489. *And, Dr. John Malone has referred to program services owned by non-MSO's as "leaks in the system" - a term that does not suggest an openness to outside investments*. Whatever the true history may be on this point, the issue for the Congress is whether a policy of separating content from conduit would best serve competition and diversity in the future.

ownership. And, Turner's CNN had occasion to face competition from another cable news service, Satellite News Channels, that was vertically integrated with cable system ownership.

Turner's response was to file a civil anti-trust complaint in Federal Court. [Cable News Network Inc. v. Satellite News Channels, Civil Action File No. C83-430A, U.S. District Court, N.D.GA.] In this complaint, Turner averred the following facts:

> 1. That cable operators maintain "a monopoly of the market for the provision of cable television programming services to cable television subscribers within the geographic area covered by each franchise." (Complaint at 16).
>
> 2. That cable operators exercise "control over a facility that is essential to the provision of cable television programming services to cable television subscribers within the geographic area covered by each franchise." (Ibid).
>
> 3. That cable operators can use their "monopoly power" to give an "affiliated entity" a "competitive advantage" over other program services. (Complaint at 17).
>
> 4. That Cable operators' monopoly power and vertical integration create "substantial barriers" to entry by other programming services. (Complaint at 18).
>
> 5. That cable television subscribers "have been and will continue to be adversely affected" by cable monopoly and vertical integration. (Complaint at 19).

Obviously, the Turner organization, now itself highly vertically integrated with cable system operators, would view the issue of vertical integration quite differently today. However, its earlier averments in its Federal Court complaint undoubtedly were truthful and reflect the bleak reality faced by both non-vertically integrated programmers and consumers. [12/]

The proposed Time/Warner and Time/Paramount mergers are causing concern among other cable programmers such as Turner, Viacom and NBC. But, the fate of Time, Inc. is but one tree in a forest of vertical integration. We urge the Congress to focus on the forest and act decisively to curb cable vertical integration generally.

12/ In response to earlier INTV citations to the CNN litigation, Turner has suggested that INTV is criticizing all vertical integration including that which exists within companies such as Fox and Tribune who own Independent television stations. Reply comments of Turner Broadcasting System Inc. in FCC CC Docket No. 87-266, January 27, 1989. However Turner is in error.

Vertical integration *per se* is not the evil. The problem lies in vertical integration by a company that enjoys market power and controls "essential facilities" in a particular line of business. Since Independent stations operate in competition with other local stations, they do not exercise market power or constitute "essential facilities". As a result, vertical integration into programming by Independent station operators simply does not pose the same anti-competitive problems inherent in cable vertical integration. It is, after all, Turner's own Federal Court complaint which sets forth the averments that cable system operators exercise "monopoly" power and control "essential facilities".

There is a parallel between the manifest problems arising out of cable vertical integration and the history of anti-trust litigation and financial interest and syndication regulatory provisions with respect to the three national broadcast networks. Both the Department of Justice and the Federal Communications Commission found that the three national broadcast networks exercised market power. Accordingly, the three networks were forced to divest themselves of their program syndication activities. To the extent that there is a lack of parallel treatment of program vertical integration by cable operators and by the three dominant national networks, the answer is not to eliminate the network regulation (two wrongs do not make a right), but rather to act in a manner consistent with network regulations to curb vertical integration in the cable industry.

C. Channel Repositioning Of Local Broadcast Stations Is Caused By Cable Vertical Integration And Should Be Prohibited By The Congress For Anti-trust, Copyright And Communications Policy Reasons

Channel repositioning of local broadcast stations is a special subset of the overall difficulties vertical integration has caused for non-affiliated programmers. Local broadcasters are non-affiliated programmers with a special copyright relationship with the cable operator, and a special communications policy obligation to the communities they are licensed to serve.

Last year the FCC conducted the first comprehensive study of cable carriage and channel shifting practices. A copy of the Commission's report is appended as Attachment No. 3 to my testimony. Responses, which were purely voluntary, were received from approximately one half of all cable operators.

In the FCC survey, 869 cable systems admitted denying carriage to 704 local stations in 1,820 different instances. Nine hundred and seventy four systems admitted shifting the channel location of one or more stations yielding almost 3,000 instances of channel shifting. In almost every instance, the stations dropped or shifted have been replaced by cable program services in which the system operator is selling advertising.

In its survey of cable practices, the FCC found the 85% of all channel shifting, according to cable operators themselves, was attributable to "marketing" reasons rather than technical necessity. INTV conducted its own unscientific study of 70 instances of channel shifting on TCI cable systems as reported to our Association. In 65 of those 70 instances, the original channel position of the local station was subsequently filled with a program service in which TCI had an equity interest. 13/

The FCC Report demonstrates that our difficulties with cable are not limited to a few hoary old anecdotes as cable advocates are pleased to allege. Moreover, these carriage and channel shifting problems continue to occur on an almost daily basis. For example, in February of this year a major Independent station in a major market received a letter from one of the very largest cable companies announcing a re-evaluation of their system's channel line-up. The letter emphasized the value of the "shelf space" the Independent station was occupying on the cable system and demanded a schedule of free advertising on the station as a condition for continued carriage. 14/

On January 1 of this year, the leading Independent station in West Palm Beach was shifted, without any warning, from channel 9 to channel 29 on a major local cable system. Repeated efforts

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13/ INTV does not mean to suggest that TCI's channel shifting record is worse than other operators. However, TCI is planning two new programming services which will gain "shelf space" and channel position at the expense of broadcasters or non-integrated programmers. Multichannel News, April 3, 1985 at 34.

14/ Curiously, the letter did not emphasize the value to the cable operator of its free compulsory copyright license to sell, for its own account, all of the programming purchased or produced by the local stations.

to resolve the issue with the local cable manager, and with senior corporate officials, have proven fruitless. [15]

In December, 1988 KICU-TV in San Francisco, was shifted off of channel 6 to make room for a cable barker channel promoting the system operator's proprietary pay-per-view service.

On January 27 of this year, the TCI system in Millbrae, California, moved three local Independent stations out of the VHF band and replaced them with three cable program services (CNN, American Movie Classics and The Discovery Channel) in which TCI holds substantial equity interest and in which TCI sells advertising availabilities. The stations received no notice of the shifts which occurred just three days prior to the start of the critical February Nielsen and Arbitron rating period. One of the stations commissioned a survey that showed that 20% of Millbrea cable households with "second" TV sets, who could formerly receive the station on those second sets, are no longer able to do so because of the channel shifts.

In several communities across the country, following system "upgrades", local stations have been shifted to high UHF channels that most consumers cannot receive even on their primary set. These systems expand from 36 to 54 channel capacity, but require consumers to disconnect their old 36 channel converter boxes and drive to the cable office to trade for new 54 channel boxes. In the meantime, local stations shifted to channel positions between 36 and 54 cannot be viewed via cable.

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[15] Local stations shifted to a channel position higher than 13 cannot be received at all on many television receivers. Non-"cable ready" sets that are connected to a cable without a converter box receive via cable only those stations and program services carried on channels 2-13. These conditions frequently exist in apartment buildings, hotels and on second and third sets in private homes (recreation rooms, bedrooms, etc.). Being shifted up is the equivalent of being removed from the system with respect to these television sets.

In all of these situations, as in all of the thousands of incidences documented in the FCC's report, local broadcast stations have access neither to competitive alternatives nor regulatory relief. Their only option is to hunker down and suffer whatever anti-competitive abuse the local monopoly cable operator chooses to dish out.

Plainly, the vertical integration of cable system operators into programming has produced a profound shift in the very nature of the cable operator's business. Previously, the system operator cared only that consumers subscribed. Now, operators also have a vested interest in what consumers elect to watch. Given the opportunity, it is inevitable that cable operators will use their control of the distribution system to compete unfairly in the programming marketplace to the advantage of their own services and to the disadvantage of competitors including local broadcast stations.

Any doubt regarding the motivation for the cable channel shifts can be resolved by the candid explanation of one major MSO -- Jones Intercable. In a May 27, 1987 letter to advertisers, Jones described its motivation for a recent channel shift as follows:

> "On March 1, 1987, Jones Intercable made changes that greatly enhanced the value of advertising placed with us. On that date, we realigned our channels bringing four of the five channels (The Nashville Network-4, Cable News Network-6, ESPN-12, and USA-8) on which we insert advertising to channel positions between 2 and 13.

> "Studies performed on viewership patterns on channels 2 through 13 show that they are viewed 30% more often than higher channel positions. This means that the advertiser's exposure to area consumers increased greatly without additional cost."

Congress should act to prohibit these channel repositionings for three distinct reasons. The first is anti-trust. It is simply inconsistent with the entire thrust of our anti-trust laws to permit cable operators, who enjoy monopoly power and control "essential facilities", to use that control and those facilities to compete unfairly in the programming and advertising marketplace. Local broadcast stations should not be rooted out of long held cable channels just because the system operator has vertically integrated into programming.

The second reason for Congressional action deals with copyright. Congress has conferred upon the cable industry the extraordinary benefit of a compulsory copyright license. This license enables cable operators to take, then to sell to consumers, all of the programming produced or purchased by local broadcast stations. The cable operator pays nothing for all of this programming which constitutes the most valuable portion of the service that it sells to consumers.

Having conferred this extraordinary privilege upon the cable industry, it seems incumbent upon the Congress to require that cable operators not unfairly abuse local stations. Simple equity and fairness require that cable operators show some modicum of consideration toward the local broadcasters upon whom the cable operators have built their business. Many cable program services include the issue of channel position when they negotiate carriage fees with cable operators. Because the compulsory license gives cable operators an absolute claim on our signals, we are precluded from engaging in such negotiations.

The third reason for Congressional action is communications policy. Cable program services are available only to those with the financial ability to pay. By contrast, broadcast stations are the quintessential democratic medium, available equally to rich and poor. As a matter of fundamental communications policy, the pay medium that lives off the free medium should not be permitted to simultaneously undermine that free medium through channel positioning practices.

In 1962, Congress passed the All Channel Receiver Act to ensure that UHF stations would have equal access to viewers. Now, built on a base of broadcast retransmission, cable has become the primary means of television delivery to over half the nation's households. However, cable technology has evolved in such a way that not all channels can be received via cable on all sets. And the cable industry has systematically relocated local UHF stations to those cable channels that cannot be received by many sets. These channel shifts are an affront to the spirit, if not the letter, of the All Channel Receiver Act.

D. Cable Has Begun to Siphon Popular Programming From Free Over-The-Air Broadcasting

To the extent that cable provides consumers with new viewing alternatives, it obviously serves the public interest. This is true even if consumers are required to pay for access to those new viewing alternatives. However, when cable becomes a device to require consumers to pay for the very same program events that broadcasting previously made available for free, it is extremely difficult to perceive how consumers' welfare is enhanced.

Like a twentieth century Trojan horse, cable rode into the American living room on the promise of enhanced reception of free over-the-air broadcast programming. Now that cable is safely entrenched in more than half of all American homes, it has set about to remove popular events from free over-the-air broadcasting and place those events instead on pay cable services.

National coverage of NFL games has begun the migration from free broadcasting to pay cable with a package of Sunday night games, including the Pro Bowl, all of which had previously been available free to consumers on broadcast stations. Major league baseball's new cable package pre-empts the rights of local free broadcasters on Sunday and Wednesday nights. Local stations are precluded from showing games for which they hold contractual rights, just because these free local games might dilute the audience for the cable monopolist's national game. In addition, the national cable package will flood the market with baseball advertising availabilities thereby undermining the economic base of free baseball telecasts.

At the local level, we see the same clear trend of sports rights packages migrating from free broadcasting to pay cable. Appended to my testimony as Attachment No. 4, is a newspaper advertisement for pay cable telecasts of Mets' games last season. This ad arrogantly ridicules those consumers who cannot afford, or have no access to, cable service, by depicting a large table radio under the headline, "If you don't have cable, enjoy watching the Mets game tonight."

In New York, station WPIX has broadcast the New York Yankees games free over-the-air to all consumers for more than 40 years. However, the contract for Yankee television rights beginning in 1991 has been granted to a cable service. The continued availability of free over-the-air Yankee telecasts, the rights to which have already been severely limited by cable purchases, remains very much in doubt as of this date.

All across the country, cable operators are creating regional pay TV networks to wrest sporting events away from free TV. For example, station KPTV in Portland, Oregon was recently notified that its contract for free telecasts of University of Oregon football and basketball had been "superceded" by a PAC-10 agreement with a TCI regional pay TV network. Contracts between other PAC-10 schools and free TV stations will be similarly impacted. To show the nationwide scope of this problem, I have appended as Attachment No. 5 an Editorial from the Minneapolis Star Tribune complaining about University of Minnesota hockey and basketball games being blacked out on free TV.

It is not difficult to see where this trend is leading us. Some cable executives brazenly predict that consumers will be required to pay to see all major sporting events, including the Super Bowl and the World Series. On the evening of last year's Spinks/Tyson boxing match, which was available on cable pay-per-view, the following news account appeared on a Norfolk, Virginia television station:

> Announcer: "Cox Cable's Irvine Hill says this fight tonight may be the wave of the future for sports on television."
>
> Irvine Hill (Cable System Manager): "If you can picture say a Super Bowl, where 50 or 60 million people are watching a Super Bowl on a given Sunday, if you say charged $50 or $60 for that, the numbers are so staggering -- so I just think you -- I just predict that you'll have things like the Super Bowl on pay-per-view in just a few years".
>
> Announcer: "And that sports fans is what some might call progress."

Similarly, Scott Kurnit, President of Showtime Event Television has offered the following vision of the future:

> Once enough homes are on line, he says the potential political problems - and accompanying public outcry - of making an event like the Super Bowl into PPV will fade away. (Electronic Media, May 1, 1989)

Even if these predictions regarding the Super Bowl and the World Series prove unfounded in the near term, it is absolutely crystal clear that consumers are losing a substantial amount of the free sports broadcast programming that they currently enjoy.

Webster defines a Trojan Horse as "a person, organization or factor that is intended, or likely, to undermine an established institution." Under the current circumstances, I can think of no more apt description of the cable industry vis-a-vis free telecasts of major sporting events.

E. Congress Should Pursue The Following Remedies Regarding The Cable Industry

1. Congress Should Enact S. 177 And/Or S. 905

Senator DeConcini, along with co-sponsors Senators Metzenbaum, Simon, Pressler and Kerry has introduced S. 177 that would condition the continued availability of a cable operator's free compulsory license to retransmit local broadcast signals upon the cable operators voluntary willingness to comply with reasonable must-carry and channel positioning requirements. S. 905, introduced by Senator Lieberman, contains the same provision. Since cable operators cannot possibly assert a First Amendment right to a compulsory copyright license, the approach utilized in S. 177 and S. 905 is constructed to avoid any First Amendment impediments.

Passage of this legislation is the single most effective response the Congress could make to the anti-competitive carriage and channel positioning practices outlined in this testimony. Moreover, the terms of S. 177 and S. 905 are reasonable and fair to the cable industry. The must-carry component of these bills incorporates by reference the FCC's modified rules that were based upon an inter-industry compromise agreement. The channel positioning component merely requires that local stations be carried (1) on the channel position the cable operator had voluntarily selected for that station as of July 1985 (prior to the onset of widespread channel shifting), or (2) on the stations's FCC designated channel, at the option of the station.[16/]

Congress should also consider whether these bills should be amended to provide a statutory formula to fairly compensate local stations for retransmission of their signals under the compulsory license just as cable operators compensate themselves for retransmission of their own vertically integrated program services.

2. Congress Should Pass Legislation Regarding The Siphoning Of Programming From Free Broadcasting to Pay Cable

Mr. Richard Kessel, New York State Director of Consumer Protection, recently observed at a public hearing that the loss of free sports broadcasts has the potential to become the number one consumer issue of the 1990's. The process of siphoning free sporting events to pay cable has already started. Congress should act now, and act decisively, before this gradual but insidious process advances any further.

Appended as Attachment No. 6 to this testimony is a draft bill that would condition the anti-trust exemption for Major League Baseball teams, and the compulsory copyright license for cable television systems, upon the provision of a fair opportunity for local over-the-air broadcast stations to televise at least 50% of a team's televised games. This draft bill is offered simply as a "thought starter".

[16/] A requirement for "on-channel" carriage alone is inadequate because non-cable ready sets without a converter box can receive only channels 2-13 via cable. And, cable operators frequently attach their cable to such sets without installing a converter box.

The bill's structure is responsive to those who would argue that the loss of major sporting events to pay cable is "just business". Neither the anti-trust exemptions that the sports leagues enjoy, nor the compulsory license that the cable industry enjoys, are "just business". At the very least, it would seem that the Congress could insure that special privileges, such as anti-trust exemptions and compulsory copyright licenses, are not utilized to undermine the public's enjoyment of free over-the-air sports broadcasts.

Another approach to leveling the playing field and maintaining the quality of Free TV, would be to provide local broadcasters with fair compensation for the value their services lend to the basic cable package. Cable operators pay for program services far less popular than broadcast programming. Two thirds of all viewing in cable homes is to local broadcast stations. Cable operators should pay fair compensation for all of the programming they use -- both broadcast programming and their own vertically integrated product. Because of the monopoly power of cable systems, free market negotiation may not be possible and a statutory payment schedule should be considered. This "second revenue stream" would help preserve the quality of Free over-the-air TV.

3. Congress Should Adopt A Revised Definition Of Cable Effective Competition

Efforts to regulate the monopoly behavior of cable systems will continue to be hampered by the FCC's finding that three over-the-air broadcast signals constitutes "effective competition" to basic cable. The Congress should enact a more meaningful definition of the circumstance under which cable systems truly might face "effective competition". A more meaningful definition would clear the way for appropriate regulatory provisions in those instances where cable does not face "effective competition".

4. Congress Should Repeal Section 621(c) Of The Cable Act And/Or Direct The FCC To Act Upon INTV's Petition For Inquiry Under Section 612(g) Of The Act

Section 621(c) of the Act provides that a cable system may not be regulated as a common carrier or a utility. [17] Given the manner in which the industry is developing, a strong case can be made that cable operators should be regulated as common carriers and that section 621(c) of the Act should be repealed. Professor Ben H. Bagdikian made this same point at last Wednesday's hearing.

Section 612(g) of the Act provides that when certain subscriber thresholds have been passed, the common carrier prohibition in Section 621(c) is no longer operative and the FCC is empowered to adopt such regulations as are necessary to promote diversity in cable communications (e.g. some form of common carrier or quasi-common carrier regulation). On December 21, 1988, INTV filed a Petition with the FCC urging the commencement of a formal Inquiry on the Agency's responsibilities under Section 612(g) of the Act. Congress should urge the FCC to initiate the Inquiry requested by INTV.

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[17] Paradoxically, cable systems enjoy a statutory right under Section 621(a)(2) of the Act to use rights-of-way and easements reserved for the use of public utilities. In fact, cable systems are the only "First Amendment Speakers" with a federal statutory right to dig up your front lawn.

5. Congress Should Require Divestiture Of All Program Investments By Cable System Operators

There is more than enough evidence to demonstrate that the 1974 Cabinet Committee Report was correct and that there should be a clear separation between the ownership of cable systems and the ownership of programming services seeking access through those cable systems. Just as the three dominant national television networks were required to divest their program syndication operations in 1970, cable system operators should be required to divest their vertically integrated programming operations.

6. Congress Should Be Prepared To Consider The Alternative Of Telephone Company Provision Of Cable Television Service, On A Common Carrier Basis, If The Cable Industry's Relentless First Amendment Litigation Succeeds In Blocking Any Re-regulation Of The Industry

INTV has not taken a position with regard to repeal of the telephone/cable crossownership prohibition in the Cable Act. However, if the cable industry's First Amendment litigation ultimately succeeds in precluding any regulatory oversight of cable behavior, then some alternative distribution path must be found to assure that consumers have access to diverse sources of video information and entertainment. Telephone companies acting purely as common carriers, without vertical integration into programming, could provide such an alternative.

III.

Congress And The FCC Should Retain The Network/Cable Crossownership Rule And The Network Financial Interest And Syndication Rule

The network/cable crossownership prohibition and the network Financial Interest and Syndication Rules are the only safeguards against a complete monopolistic consolidation of the television industry. The retention of these rules is critical to the maintenance of competition and diversity. Repeal of these rules would lead to megamergers of network-studio-broadcast-cable interests destroying the current balance of power in the marketplace and depriving consumers of the benefits of competition and diversity. This prediction is not just idle speculation as demonstrated by the following remarks of Mr. Nicholas J. Nicholas, Jr. of Time, Inc.:

> "'We're on the offense, not the defense.' Within five years, as he sees it, 'a major reshuffling of the deck' will result largely from further deregulation. 'First, within a year,' he predicts, 'it will become legally permissible for cable companies and broadcasting networks to own each other. Second, probably a year after that, relationships will change between broadcasting networks and production companies in television and movies. They will be permitted to own each other.'
>
> "As a result, all such companies would become attractive targets for acquisition, merger and joint venture." New York Times Magazine, February 26, 1988 at p. 47.

We sincerely hope that Congress does not share Mr. Nicholas' vision of the future.

A. The Network/Cable Crossownership Prohibition Must Be Retained

The Independent stations, the ABC affiliate stations, the NBC affiliate stations and the CBS affiliate stations are in complete and total agreement that the network/cable crossownership prohibition must be maintained. This unusual unanimity reflects the pervasive fear that futher cable vertical integration into the ownership of broadcast networks would increase the incidence of anti-competitive cable carriage practices. No local broadcaster wants to be at the mercy of cable carriage decisions made by a competitive broadcast network. It's bad enough that we are at the mercy of decisions made by the owners of competitive cable networks.

The competition and diversity that have long been cornerstones of our national communciations policy are under attack today by increasing merger mania. The Congress and the FCC should not further contribute to this unfortunate trend by facilitating mergers between cable MSO's and broadcast networks. In particular, we would urge the Congress to resist the argument that the goals of competition and diversity must be sacrificed on the altar of "international competitiveness".

B. The Network Financial Interest and Syndication Rules Should Be Retained

The Independent stations do not seek a quarrel with the three national television networks. As fellow broadcasters, we share many interests in common with the networks. In particular, the Independent stations are working closely with the networks to help insure the long term survival of free over-the-air broadcasting in this country.

However, we strongly support the retention of the Financial Interest and Syndication Rules. First, as noted above, these rules constitute the only bulwark against a mad rush of megamergers between production studios and television broadcast networks. Secondly, and more importantly from our standpoint, these rules represent the Magna Carta of Independent television. They constitute our only assurance of free and unfettered access to popular off-network programs in a competitive marketplace.

The Financial Interest and Syndication Rules enjoy an unique distinction among Federal programs -- they work! Specifically, the rules have succeeded in their stated goal of stimulating the growth of the program syndication marketplace and the growth of Independent television stations. The result has been an enhancement of competition and efficiency in the television advertising marketplace. All of these benefits could quickly disappear if the rules were repealed.

Prior to the adoption of the Financial Interest and Syndication Rules, the FCC found that the networks exercised nearly complete domination over broadcast television. According to the FCC, the networks took a financial interest in virtually all the programs they exhibited. The syndication marketplace was somewhere between moribund and nonexistent. There was only a handful of Independent stations. The American people had access only to such programming as emerged from what the FCC described as "the three network funnel." Moreover, the networks were in a position to dictate terms in the television advertising marketplace.

The Financial Interest and Syndication Rules have produced a dramatic increase in the number of first run prime time syndicated programs. According to Variety Magazine the number of such programs increased from zero in 1970 to 84 in 1988, not counting 35 additional children's programs. The Rules also succeeded in stimulating growth in the number of first run program producers. Again according to Variety, the number of producers rose from 0 in 1970 to 54 in 1988.

The Financial Interest and Syndication Rules also provided a healthy stimulus to the growth of Independent television stations. In 1970 there was only a total of 65 Independent television stations in the entire country. In 1988 that number had risen to over 300. Our share of the viewing audience has gone from negligible to approximately 25%, demonstrating that consumers enjoy the new viewing alternatives that our stations provide. Unfortunately, financial success continues to elude many Independent stations. According to the most recent data available from the National Association of Broadcasters, the average Independent station lost $68,000 in 1987. The average UHF Independent lost over $1 million.

By contrast, the networks and their affiliates continue to enjoy enormous financial success. In 1987 the NAB's study reflects an average network affiliate profit in excess of $4 million. In 1988, the three networks combined broadcasting profits exceeded $1.5 billion. Together, the networks and their affiliated stations capture more than 83% of all advertising dollars spent on television.

Given these figures, repeal of the Financial Interest and Syndication Rules cannot be justified on the basis of alleged network financial hardship. Analogies to the vertical integration that is currently permitted in cable is similarly unpersuasive. Simply stated, two wrongs do not make a right. As noted earlier in this testimony, Congress should act to curb vertical integration in cable -- not extend the phenomenon to broadcast networks.

IV.

Conclusion

Our free broadcast system is a national resource of inestimable value. But, it cannot be taken for granted. Unless Congress acts quickly to curb vertical integration and re-balance the cable-broadcast relationship, the American people will be made to pay for the services they now receive for free.

Congress should also support retention of the Network/Cable Crossownership Rule and the Network Financial Interest and Syndication Rules.

RESPONSES TO SENATOR INOUYE'S QUESTIONS

Question #1:

Cable systems pay to carry all program services, even advertiser supported program services, except for over-the-air broadcast services. Should cable pay to carry local television signals?

Response - Yes. The public interest in the continued economic viability of free over-the-air television service requires a rebalancing of the economic relationship between cable and broadcasting. Cable subscribers view broadcast stations 70% of the time, indicating the relative value they attach to local TV signals as compared with cable program services. Cable companies (1) take broadcast programming for free; (2) package it with their own proprietary program services; (3) sell the package to consumers for a single combined price; (4) use a portion of the resulting revenue stream to nourish cable proprietary programming and bid program rights away from free TV.

Over time, cable services, with two revenue streams, will be able to outbid free television stations (that rely soley on advertising) for popular program product. This process has begun with respect to sports events that have moved from free to pay TV.

Question #2:

You urge the retention of the Network Financial Interest and Syndication Rules, primarily because of concern that the networks would discriminate against Independent stations in the distribution of programming. Would you oppose relaxation of the rules if the networks were prohibited from participating in the distribution of syndicated programming?

Response - The Independent stations are concerned about any network financial interest in programs licensed for network telecast. Professionals in the broadcast business know that the networks could use such financial interest to directly or indirectly influence the syndication process by means that would be undetectable by any government authority.

However, the Independent stations have consistently expressed their willingness to explore compromise resolution of these issues. The program producers have invited the Independent stations to participate in the ongoing negotiations. Unfortunately, the networks refuse to permit the Independent stations to join these talks.

Enclosed is an exchange of correspondence which demonstrates the difficulty the Independent stations have had in gaining access to the negotiations. Plainly, we cannot consider a compromise solution if the networks do not permit us to participate in the compromise negotiations.

Question #3:

Do you believe that the FCC's definition of a network is sufficient or does it need to be relaxed?

Response - This is an issue that has not been considered by the Board of Directors of our Association. As a result, our Association has no current position with regard to the FCC's definition of a network.

Question #4:

If the networks were to create a program cooperative along the lines of the cooperative proposed by Fox Broadcasting for its children's programming, would you oppose the proposal?

Response - Our position with respect to any program cooperative established by the three national networks would depend upon the purpose and structure of such a cooperative.

RESPONSE TO SENATOR KERRY'S QUESTION

Question:

Mr. Padden, earlier I asked Mr. Mooney if Congress should consider insuring a certain allocation of cable channel capacity among local broadcasters, vertical cable programmers, and independent programming. Do you agree with Mr. Mooney that there is no evidence that cable carriage of local broadcasting is declining?

Response - No, I do not agree with Mr. Mooney's assessment of the situation. Last year, the FCC conducted a study of cable carriage and channel shifting practices. Voluntary responses were received from approximately one half of all cable operators. In the FCC study, 869 cable systems admitted denying carraige to 704 local stations in 1820 different instances. A complete copy of the Commission's study is appended at Attachment #3 to my written testimony.

Also, ESPN is strictly a programming service and not a "cable monopolist" as your testimony implies. The "flood" of advertising availabilities which you allege will take dollars out of your members' pockets really reflects competition and greater consumer choice. A new Baseball product will be available in the marketplace that adds a series of national games never available before.

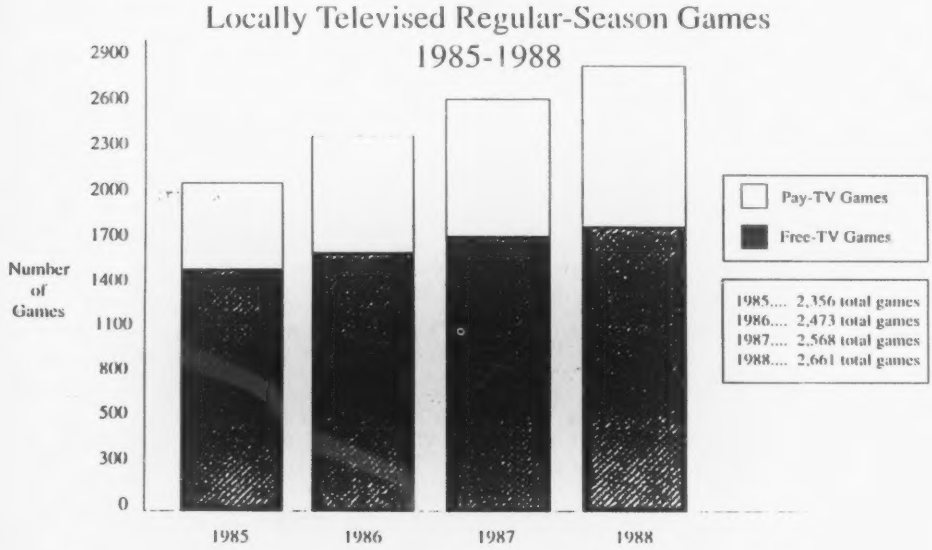
Baseball's television activities on both the local and national level will excite our fans, are pro-competitive and should, in fact, help your members. We make an enormous inventory available over several mediums and maximize local club options. Given these facts, the "discussion" legislation you proposed (now Rep. Schumer's bill) is not warranted.

Let me conclude, therefore, where I began. We share many of your cable concerns and support Congress' continuing review, but the alleged move of Baseball off local telecasts to cable is not supported by the facts. The premise of your remarks to Congress was false, and we urge that you keep this in mind as you formulate your views and public comments on these issues.

Very truly yours,

Edwin M. Durso

Edwin M. Durso
Executive Vice President



Locally Televised Regular-Season Games
1985-1988

Senator **Inouye**. My only regret is that more members are not present to listen to this panel.

The next witness is Mr. Bob Phillips, Chief Executive Officer of the NRTC.

STATEMENT OF BOB PHILLIPS, CHIEF EXECUTIVE OFFICER, NATIONAL RURAL TELECOMMUNICATIONS COOPERATIVE, WASHINGTON, DC

Mr. **Phillips**. Thank you very much, Mr. Chairman.

The National Rural Telecommunications Cooperative is comprised of 550 rural utilities that serve sparsely settled areas in 47 states. They are trying to bring affordable and diverse programming to those television homes in rural America where 20 to 30 million people live with poor off-air reception and will never be reached by cable.

I am pleased you invited me today to testify.

Given our experience we believe also that concentration of media ownership in the cable industry is a major factor that thwarts the development of the home satellite dish industry.

One year ago this month in this very building congressional pressure helped NRTC secure contracts with HBO and Cinemax with TCI's Netlink service and with Viacom's Nickelodeon service, among other programs.

These contracts were heralded at that time as evidence that the marketplace for the dish owner was working, and it is true that these were the first third party cable-like contracts that were extended to a dish market distributor.

While we are grateful for those contracts, I am here today to tell you that this marketplace is far from healthy, competitive and stable. You can ask any satellite dealer, the Dish sales today are down by 40 percent, and even our own trade group, the Satellite Broadcasting and Communications Association, sent a report out that I received yesterday citing continuing consumer confusion regarding legality, access, and cost as key, contributing factors.

Our experience demonstrates that program pricing is discriminatory. Competitive access to programming is restricted, and programming theft is an unfortunate result that has run rampant in the dish market.

NRTC does buy programming at wholesale for its members who do distribute Rural TV to more than 30,000 rural homes. Our members provide the same support and service that a local cable system provides. Yet when NRTC approaches programmers and carriers for contracts, we are not treated on a par with cable distributors.

Our wholesale costs for our 17 channels in the Rural TV Plus basic package are on the average cost 444 percent more than the wholesale cost to cable for those same 17 channels.

Senator **Gore**. Could you repeat that figure?

Mr. **Phillips**. I said that the 17 channels that we have in our Rural TV Basic Plus package cost on the average 444 percent more at wholesale than a cable distributor would pay for the same 17 channels.

The range is around 167 percent to 780 percent, and I will give you an example of the 780 percent figure. Mr. Malone of TCI testified before you last week. His company owns 100 percent of the carrier service that uplinks Superstation TBS. Cable systems can buy that signal between four and ten cents per subscriber per month. But NRTC must pay 78 cents per month. That is a 780 percent difference.

There is no valid reason for that wholesale price disparity, and we believe that the price disparity is linked to vertical integration of programmers, satellite carriers, and large cable operators.

Despite our efforts over the past two years to gain access to programming and with congressional help to do it, we cannot gain access to some of the scrambled programming at any cost.

I have supplied for your information as Attachment C, Mr. Chairman, a letter that we received from Ted Turner's new TNT service.

There are two outlets in the home dish market for TNT. You can buy direct from Mr. Turner or you can buy it through your local cable operator for your home satellite dish. Now, you would think that since TNT is also a new service that has just launched this year and they need to add subscribers to grow that they would want to give distribution to NRTC so that we could provide their signal to our 30,000 rural homes. But, they flatly refused with no answer, and the letter stating that is attached.

There are other examples. Viacom did deal with us last year to sell Nickelodeon, but they continue to refuse to sell MTV and VH-1 that were mentioned here today. They also refuse to sell us Showtime and The Movie Channel.

And I think it is very interesting to note that Viacom, who has filed a lawsuit against HBO citing HBO's monopoly control and the refusal to allow them access to the market has used the same tactics against NRTC in the dish market.

This unfair treatment by cable has unfortunately provided an incentive to the dish owner to illegally steal programming. We certainly do not condone theft of programming, but you must recognize that consumer confusion and anger, in fact, about these disparities that I have just explained have contributed to the development of this improper customer response.

And I would like to note for the record that, based on the wholesale pricing disparities between cable and home dish pricing, the level of piracy could reach 80 percent before most of the programmers would realize less of a return from a dish subscriber than they do now from wholesale cable sales.

Dish owners know that the cable industry fears the development of competing technologies such as the dish because they pose a substantial potential threat to cable's asset value, and that is the very reason that we are also alarmed by recent reports that several of these major multiple system operators are now close to a joint venture in the direct distribution of programming by KU band direct broadcast satellites.

Our industry is now pondering whether these MSOs are going to buy up KU band capacity to stifle direct broadcast or whether they are going to completely control this delivery technology which does hold great promise for lower cost and better reception for rural areas.

Neither scenario, I assure you, will foster a competitive market or serve rural consumers.

Mr. Chairman, we want to thank Congress for its diligence and support.

It was only a few years ago that Congress provided the cable industry protection from the broadcast industry. Congress was instrumental in the success that cable enjoys today.

We believe that the dish market needs the same kind of support from you, and we would ask that you consider the following recommendations.

First, we would like to see that programming access is equally available to all qualified distributors, regardless of the method of distribution at retail.

Second, we think you should mandate fair terms, conditions and pricing for that programming at wholesale again, regardless of the delivery technology.

And finally, we would like you to consider banning or limiting the ability of cable entities from participating in the direct broadcast market just as cross-ownership restrictions were adopted to promote diversity of ownership in other telecommunications technologies.

Mr. Chairman and members of the subcommittee, the home dish market is not working for the consumer, and our experiences clearly indicate that media concentration has been a major impediment.

Thank you.

[The statement follows:]

STATEMENT OF BOB PHILLIPS
CHIEF EXECUTIVE OFFICER
NATIONAL RURAL TELECOMMUNICATIONS COOPERATIVE

HEARINGS REGARDING
MEDIA OWNERSHIP: DIVERSITY AND CONCENTRATION
COMMUNICATIONS SUBCOMMITTEE ON COMMERCE,
SCIENCE AND TRANSPORTATION
UNITED STATES SENATE

June 21, 1989

Thank you Mr. Chairman and members of the Subcommittee. My name is Bob Phillips. I am the Chief Executive Officer of the National Rural Telecommunications Cooperative, a national organization of 550 rural electric and rural telephone systems serving the sparsely-settled areas of the United States. NRTC is deeply committed to providing access and affordability of television programs to rural households through the home satellite dish. As I've testified before Congress in previous hearings, the satellite delivery technology is ideally suited to serving rural America, where an estimated 20 to 30 million consumers suffer poor off-air reception and will never be served by cable television.

I am pleased that the Subcommittee has decided to hold these hearings. I am also pleased and gratified that the Subcommittee has invited me to testify on the topic of media ownership and control. Given NRTC's experience during the past three years in the development and marketing of "Rural TV" programming package to rural home satellite dish (HSD) owners, we have grave concerns about the increasing concentration of media control in the hands of a powerful few. We believe concentration of media ownership in the cable industry is a major factor thwarting the development of the HSD market. Despite years of work and effort, great hopes and the dedication of thousands of peoplein the industry, we believe that the HSD market is still not working to the benefit of consumers.

One year ago this month, Congressional pressure helped NRTC secure contracts in this very building with HBO/Cinemax, The Disney Channel, Viacom's Nickelodeon service, TCI's Netlink service, and The Nashville Network.

These contracts were heralded as evidence that the home satellite dish marketplace was working. We characterized the contracts as a significant "breakthrough" for they were. They were the first cable-like contracts established by these programmers with an independent third-party packager. Since those contracts were signed, NRTC has worked in earnest and our subscriber base has increased from 9,000 to over 30,000.

While we are grateful for these contracts, and indeed our very existence was tied to securing them, I am here today to say that the marketplace is far from the healthy, competitive and stable marketplace it could be.

We believe Congressional action is needed to insure that the our "breakthrough" of last year becomes a broader force for the HSD market and for millions of unserved rural Americans.

Today, I would like to review with you the following points:

*Discriminatory pricing at wholesale and the retail level in the HSD consumer market continues to be a major problem.

*Access to programming continues to be a major problem.

*Consumers' confusion about programming access, the high cost of programming, and an expensive descrambling technology has driven a significant majority of the HSD marketplace to the illegal reception of scrambled video transmission.

*Multiple System Operators (MSOs) of cable systems are now moving to control the high-powered Ku-Band satellite technology to lock-up the future of direct broadcast satellite service, further eliminating the risk of a potential competitive technology.

Overview

Certainly the issue of media control, the vertical and horizontal integration by cable, and the difficulties of the HSD market are well known to Congress. Congressional staffs have, on numerous occasions, told us of the highly charged emotional response they've received from constituents on the topic.

The simple facts of concentration of cable ownership are easy to demonstrate. Broadcasting Magazine reported in May that 7800 cable systems provide service to consumers in the United States. Cablevision, a cable management magazine, shows that the 25 largest multiple system operators (MSOs) serve 72 percent of the 49.5 million cable households in America. Stated another way, less than 1 percent of all cable companies provide service to 36 of the 49.5 million cable homes in the nation.

Mr. Chairman and members of the Committee, you are also well aware of the level of vertical integration by the industry as it has been described to you in previous testimony. Concentration does indeed exist.

Still, these hearings must examine the extent to which that concentration of ownership affects the natural forces of competition which must exist in any industry for it to grow to maturity. With this thought and a consideration of our experiences, NRTC must conclude that the HSD market is not working.

It is not working to the benefit of the equipment manufacturers--several have bowed out of the HSD market in the past year.

It is not working to the benefit of equipment dealers and distributors who see current satellite system sales figures falling far below those of years past, and who, in some cases, must turn to the sales of illegal descramblers or leave the business.

It is not working for the programmers who have experienced a substantial decline in the legal home satellite dish population due to a largely unchecked growth of programming theft through tampered descramblers.

And most importantly, it is not working for consumers who too often have indicated to NRTC and its member rural utility systems that:

1. The market is too risky and too unstable for their investment of hard-earned dollars;
2. Prices for programming and equipment combined put home satellite systems out of reach of their budgets;
3. They are confused, frustrated and angry about the development of the HSD market; and
4. They are looking for access to information and fair treatment by a credible industry.

Each of these issues creates a barrier to consumer comfort which has frustrated the existing base of 2.4 million HSD owners and thrown cold water on the interest of potential dish owners.

In this overview, it must also be recognized that the HSD industry represents a competing technology to cable and is viewed as a potential threat to cable. This perceived threat is heightened with the potential for true Direct Broadcast Satellite service (DBS) and its small parabolic or flat-plate dishes.

I'd like to detail our experiences which underscore the reasons we believe the HSD market is not working.

Pricing

In January 1986, HBO became the first popular cable service to scramble its programming. It sold its signal for $13 a month direct to HSD consumers "lucky" enough to have independently purchased a $400 descrambler. This monthly amount was at least 25 percent higher than the price paid at retail by a cable consumer.

As the number of scrambled channels increased, it became apparent to the HSD owner that they were being penalized in pricing and access. The HSD owners' knew that all they received for their subscription was programming.

They owned their own signal receiver. Yet the price they paid was higher than that paid by the cable subscriber who was not required to invest in a dish.

No one in the cable industry acknowledges that total out-of-pocket costs to the home satellite dish owner includes not only programming, but the cost and maintenance of the reception hardware--the satellite earth station. This common and mistaken attitude persists in today's discussion of cable programming costs vs. costs to the HSD consumer. A simple example underscores this point.

TCI, the nation's largest MSO, serves both the cable consumers and the HSD owner. TCI, together in a local partnership, has ownership in District Cablevision of Washington, D.C. Recently, several areas of the city began to receive cable service. Residents are offered a basic service of 48 channels for $17.50 per month--an average of 36 cents per month per channel.

In testimony before this Subcommittee, TCI President John C. Malone, said that TCI sells a package of HSD programming for $11.50 per month, "$5.00 a month cheaper than our basic service to cable subscribers." The package, offered by TCI's Netlink, is comprised of 15 scrambled channels of programming--that is an average of 72 cents per month per channel at retail.

This clearly demonstrates how misleading his statement was, considering the pricing at face value. Home satellite dish programming prices are twice as high as cable. But, Mr. Chairman, even with this blantant pricing discrepancy, there is a basic problem with this comparison.

To receive a satellite signal, the consumer must spend between $1,800 to $2,500 for a satellite system plus the installation cost. The cable consumer's delivery system cost is included in his retail bill. The following table puts cable vs. satellite dish pricing on equal ground.

CABLE PROGRAM RECEPTION VS. HSD PROGRAM RECEPTION

Delivery System	**Cost of Method of Delivery(Cable or Home Dish)/Mo.**	**Program Cost /Mo.**	**Total Cost /Mo.**
TCI/District Cable	-included in cost of programming	$.36 per channel for 48 channels	$17.50
TCI/Netlink	Typical HSD system cost of $49.95 per mo. over 5 years	$.72 per channel for 16 channels w/ retail of $11.50/mo.	$61.45

*For a more in-depth analysis of cable costs vs. home satellite dish, please see Attachment A

The disparity in this simple TCI example between the actual out-of-pocket costs to the cable consumer vs. the HSD consumer, with all things being equal, shows that the cost to an average HSD owner is 350 percent higher than to cable. The cable industry's continual reference to equal programming prices between cable and the HSD market without consideration of the consumer's cost of the satellite hardware must stop! The rural consumer incurs expense for equipment to receive the programming. The cost of reception equipment and programming is included in the the cable consumer's bill.

We can further underscore the pricing discrimination against the HSD consumer by reviewing NRTC's experience as a wholesale distributor to the HSD market.

NRTC purchases programming at the wholesale level for its members who distribute the "Rural TV" programming package to more than 30,000 subscribers. At the consumer level, NRTC members provide the same level of support and service as does a local cable system. NRTC members authorize and deauthorize consumer equipment. They market and advertise, build awareness and educate. They bill the consumer. And they answer untold questions about service when something goes awry.

NRTC guarantees collection and payment and the programmers and carriers receive one monthly check for all our subscribers. Like a local cable company, NRTC and its members provide consumers a "one-stop shop." In addition, NRTC members bring a high level of credibility to the retail market.

Quoting from testimony before this Subcommittee, TCI's John Malone said last week, "We have no financial or managerial control over any national cable programmer in which we have invested, and our investments are primarily passive."

We have talked to American Movie Classics (AMC) about its inclusion in our "Rural TV" programming package. AMC, of which TCI has a 50 percent ownership, has agreed to sell to NRTC, but only if included in our basic package. However, AMC will not extend to NRTC a basic package rate comparable to that offered cable systems, which is 35 cents per month or less. AMC has offered to sell its services to NRTC for $1.00 per month. Also, we are not aware that AMC requires cable operators or SMATV systems to place their service in basic.

Mr. Chairman and Subcommittee members, TCI's HSD Netlink package includes AMC as a basic service. I assume that AMC is charging TCI $1 per month per subscriber for AMC's inclusion in its HSD package, because TCI is, after all, only a 50 percent "passive investor."

Since Mr. Malone told the Subcommittee how genuinely concerned he was about the escalating wholesale cost of programming, I ask:

1. Is TCI willing to pay $1 per HSD consumer for AMC's service?
2. On the otherhand, if TCI does not pay $1 per month per HSD subscriber for AMC, then why is AMC discriminating against NRTC? and,
3. Why should cable distributors buy AMC for $.35 while the HSD distributer must pay $1.00?

NRTC cannot accept this high rate, nor can we find a justification for AMC's discriminatory pricing other than as a competitive barrier or an opportunity to realize unconscionable margins from the HSD market. In either case, AMC and TCI will benefit if we accept these distribution terms.

Other examples of TCI price discrimination exist. Mr. Malone failed to inform you that TCI owns 100 percent of Tempo Enterprises, Inc., and its subsidiary, Southern Satellite Systems, Inc. which uplinks Superstation TBS.

Before the Satellite Home Viewer Act of 1988 passed, all Superstation TBS HSD distributors were agents of Southern, with no control over price or other key competitive elements. And unlike cable, all HSD sales were annual, collected and remitted in advance to Southern. Competitive pricing was blocked, as all HSD distributors were required to collect $19.95 per year retail from HSD customers.

At the end of March, Southern sent letters to all HSD distributors cancelling the previous contracts and automatically implementing a new contract. In the new contract, Southern increased its annual rate by 70 cents, blaming the increase on additional copyright costs proscribed by the new Satellite Home Viewer Act. (see Attachment B) We are appalled that a Federal law intended to provide stability and fairness in the young HSD market has been used as a basis for increasing an already discriminatory price for service to the HSD market.

But then again, why should we be alarmed by a 70 cent per year increase. When TCI's Southern Satellite sells to a cable operator for retransmission of the TBS signal to the cabled home, it costs the operator between 4 cents and 10 cents per month per subscriber. But, if you are an HSD distributor and your consumer receives the signal direct at his home by satellite dish, your price as a distributor is 90 cents per month per subscriber. Taking into account the increased copyright cost, the adjusted HSD price would be 78 cents (90 cents minus the 12 cent copyright fee). Seventy-eight cents compared to $.10 is a wholesale price difference of 780 percent.

Mr. Malone includes Superstation TBS in his HSD basic service package. Is TCI paying its own company, Southern Satellite, more for HSD distribution rights than for cable distribution rights?

TCI also owns 80 percent of Netlink, another direct competitor to NRTC in the HSD market and a carrier of five Denver network and superstation signals. TCI's Netlink markets five Denver stations to cable systems for 58 cents per month per consumer. It markets the same five channels to NRTC for $3.25 per month. Normalizing the copyright distinction between cable and HSD distribution, NRTC's adjusted rate would be $3.01 ($3.25 minus $.24 copyright fee). Compared to the 58 cents which cable pays for these five channels, the HSD wholesale price disparity is 519 percent.

TCI is not the only example of pricing discrimination. Eastern Microwave Inc. (EMI), a subsidiary of Newhouse Broadcasting, provides its WWOR and WSBK signal to cable and SMATV operators for 18 to 20 cents per subscriber per month. EMI has advised NRTC that its lowest base rate for any third-party marketer to the home satellite dish market is $1.34 per subscriber per month. Normalizing the copyright distinction between cable and HSD distribution, NRTC's adjusted rate would be $1.10 ($1.34 minus $.24 copyright fee). Why should NRTC pay 611 percent more than cable for these two superstation signals, when it provides the same function as a cable system?

It has been our experience that major cable programmers cater to the cable monopoly in structuring their business arrangements for the HSD market.

Turner Cable Network Sales, Inc. has admitted to NRTC that our wholesale rate for CNN and Headline News is greater than the wholesale rate they charge cable operators who distribute CNN and Headline News to the HSD market. These cable operators pay Turner one price for the services when they sell them to cable customers and another price when they market the same services to HSD consumers. Turner has established a third pricing schedule--a higher rate for NRTC distribution to the home dish market. Because Turner Home Satellite is also a programming packager, they have little incentive to provide a level playing field to a competitor.

I also must ask why Turner discriminates against NRTC in favor of cable operators who also compete against Turner in serving the HSD marketplace? In this example, both Turner and the cable operators have a competitive advantage over NRTC.

We believe the price of programming is too high and discriminates against the rural market. Rural Americans, with no chance of ever receiving cable service, are being penalized by an attitude that does not credit them with their investment in equipment. And they are being penalized by programming costs many, many times higher than that paid by cable systems for the same signal.

NRTC has analyzed its wholesale cost for our "Rural TV" Basic Plus package vs. the typical wholesale cost for a cable operator if it were delivering the same 17 scrambled program services to a cable customer. NRTC's wholesale cost for the 17 channels is 444 percent higher than what a typical independent cable operator would pay. The disparity for individual programming services ranges from a "low" of 167 percent to 790 percent.

NRTC can find no valid basis for the extreme wholesale price disparities that exist throughout the cable, network and superstation programming pricing structures.

Access to Programming

Our members continually ask us about the future availability of programming services to which we do not currently have access. Certainly consumers want to obtain their favorite programming easily and conveniently. And I can state unequivocally, that NRTC's utility members want to provide a full menu of programming to their consumers. But, NRTC cannot gain access to all scrambled satellite programming for distribution to Rural TV subscribers. Access is stifled by programmers who are competitors to NRTC in the HSD market. Access to product is used against NRTC as a competitive edge. And preferential treatment within the cable community for cable-based access to programming exists, giving cable a distinct advantage over a non-cable competitor like NRTC. Let me explain our difficulties in programming access.

Turner Broadcasting's latest programming service, Turner Network Television (TNT), is not available to NRTC for distribution to the HSD market under any circumstance. TNT, Turner's "crown jewel," is available to HSD consumers only through two outlets--the local cable operator who has exclusive distribution rights to the service, or directly through Turner Home Satellite. No other access, no other competition.

NRTC has requested TNT distribution rights on several occasions. We have offered to place TNT in our basic package and provide it to all 30,000 "Rural TV" subscribers. We thought Turner Broadcasting would want us to bring TNT to these households since it is a new service trying to build a large viewership base. A letter from Turner Broadcasting reflects their attitude toward allowing NRTC to distribute TNT--they "simply cannot do {it}." (See Attachment C)

Although Viacom Networks did provide distribution rights to its Nickelodeon service last June as part of our contract "breakthrough," its Showtime and

The Movie Channel have not been available to NRTC. This has affected NRTC's ability to compete and to meet our rural consumers' needs. A recent NRTC member survey shows that they receive many requests for these two premium services. There are also those who request Viacom's M-TV and VH-1 programming services. Distribution rights for these four services to NRTC have been repeatedly denied by Viacom.

Viacom is very clear and direct about its desire to control distribution of their programming services to the HSD market. They want to use their exclusive distribution of product as a competitive advantage, but they do make exceptions.

A North Dakota NRTC member which markets satellite equipment and "Rural TV" also operates several small cable systems. As a cable company, the NRTC member has HSD distribution rights for Showtime and The Movie Channel within its cable franchised service areas only. They feel that they must offer consumers everything, even if it is not offered in NRTC's "Rural TV" package.

The North Dakota utility inquired of Viacom about the possibility of distributing Showtime and The Movie Channel to local consumers who use the utility's HSD equipment but live outside their franchise area. A Viacom executive told them that "anything outside your cabled area is Viacom's area and no one, other than Viacom, should have any right to sell there."

The North Dakota utility system informed NRTC that a satellite dish owner 2 miles outside its cable area is being provided Viacom service through a TCI cable system, despite the fact that TCI's closest cable system is 50 miles away. As the NRTC member states in his letter to NRTC (See attachment D), "Evidently if you are big enough, Showtime can make exceptions (to their distribution rules)."

Viacom is the largest single marketer of programming to the HSD market. It is ironic that the #1 HSD program provider has now filed suit against HBO, the #1 marketer of premium services to the cable industry. In its suit, Viacom cites against HBO many of the same anti-competitive abuses they've used to their own advantage in the HSD market. Viacom has reached the top of the HSD market by:

*restricting wholesale access to an exclusive programming product from retail level competitors; and

*establishing exclusive territorial boundaries

NRTC simply wants for the HSD market what Viacom has asked for its in its anti-trust lawsuit--fair treatment.

The "territorial exclusivity game" is not only being played inside hard-wired cable boundaries. Territorial marketing restrictions for programming services have also been widely adopted for the HSD market.

We have recently learned that TCI is now requesting county-wide HSD franchise areas in Wyoming. Considering the consolidation of the formerly independent Netlink and Tempo Enterprises into TCI, and TCI's aggressive posturing in the marketplace, it is reasonable to presume that they may use franchise rights as the basis to obtain more exclusive distribution rights for programming.

Even one traditional broadcaster, NBC, has recognized the necessity to honor cable franchised boundaries. CNBC, NBC's new cable programming service, has followed the trend of offering territorial exclusivity to cable systems. This preferential treatment, with its distinct cable focus, can only serve to exclude competition from the distribution of popular channels and in effect, put competitive technologies at a disadvantage.

These artificial franchised boundaries are unnecessary in the HSD marketplace. Satellite technology requires no public easements or rights of way. The only practical purpose for these territorial boundaries is to exclude competition and protect cable technology.

Access to programming, just as with program pricing, is a critical element in creating and sustaining a competitive position. Restricted access to programming products by a wholesale programmer which is also a retail competitor, reflects the vertically integrated nature of the market and the basic barrier in the development of a competitive market. Without fair and ready access on a consistent, technology-neutral basis, an independent entity like NRTC cannot sustain itself in the market.

The programmers pick and chose those outlets to which they will provide distribution rights. But they have not done so based on the quality of an organization's marketing expertise, the financial integrity of the distributor, the size of the potential market, or the lack of cable access (as in rural areas). In all of the cited cases, the programmers have consistently favored the dominant delivery system for their product--cable.

Programmers which may not be owned in total or directly controlled by cable companies know where the majority of revenues come from and to protect their place in the valuable cable market, they queue up.

NRTC's experience in programming access gives us great cause for concern for the future of competition in the marketplace. Programming content is the key to the success of any technological delivery system, be it cable, HSD, MMDS, SMATV or fiber optics. Without fair and equal access, the delivery system is doomed.

NRTC believes that left unchecked, the trend towards restricted access and franchised exclusivity will increase, with the goal of beating back competing technology. Left unchecked, lack of access will be used as a successful strategy for the cable industry to limit potential cable competitors' ability in this market.

Effect of Pricing and Access Problems on the HSD Market

The theft of scrambled programming signals has become a major problem in the HSD market. In fact, it is so serious that it threatens the future of the industry.

Although we do not condone this illegal activity, it is not difficult to understand why it has occurred. The problems I've described in the testimony have provided an incentive and rationale for illegal theft of signal activities to flourish. Program pricing to the HSD market is out of line. Access is difficult and the consumer's understanding of the distribution system has been confused. Anger towards the programmers and cable industry has also been an element in the development of a base of illegal HSD consumers.

While I know that it is not the subject of this hearing, monopoly control and pricing of the scrambling technology have also motivated illegal theft of the programming signal.

These factors have combined to provide the incentive for an illegal descrambler trade to grow and flourish. Fairly priced HSD programming alone would reduce the incentive to illegally pirate HSD signals.

Our experience indicates that programmers do not agree with this simple analysis of consumer motivation to pirate programming. A letter from Turner Broadcasting underscores their lack of concern for HSD consumer pricing sensitivity. (See Attachment C)

This attitude of programmers is more easily understood when one reviews the level of piracy which a programmer can afford to accept based upon the comparison of HSD prices relative to cable. On average, programmers can tolerate an 80% piracy level before they will realize a lower revenue per viewer from the HSD market compared to the cable market.

Unfortunately, rural American sellers and buyers alike have conducted HSD business outside the law, simply out of disgust and resentment toward their treatment by the industry. We recognize that significant amounts of revenue to programmers have been lost to signal theft. Our question is, relative to programmer losses, "How long and to what level will programmers accept these losses before they take radical actions towards the home dish market?" There are currently 1.6 million descramblers in the market. If programmers render the current base of 526,000 authorized desramblers useless by moving to new or advanced descrambling technology, will the legal-paying consumer be left with worthless, but expensive, VideoCiphers?

Discriminatory pricing, consumer confusion, and rampant piracy which threaten the future of the HSD industry are of little concern to cable. The cable industry has no stake in the development of technology to serve homes outside their franchised areas if that same technology poses a real or potential threat to the value of their assets.

MSO's Involvement in DBS

Mr. Chairman and Subcommittee members, we have recently heard and read reports that several major MSOs, including TCI and Time Inc.'s American Television and Communications Corp., have discussed a joint venture in the direct to home broadcast satellite programming delivery (DBS) using General Electric's higher-powered Ku-Band K1 satellite and smaller and more affordable consumer satellite equipment.

The concept, which could put 12 to 14 services on a satellite and would be a significant attempt in Ku-band DBS, has been heralded as the home satellite system of the future.

If the cable MSO's are allowed to buy-up Ku band capacity, cable will be able to control what might otherwise develop as an effective competing delivery technology.

We have shown that rural residents, dependent on HSD technology for information access have not been treated with fairness or equity by the cable industry in the past or currently. Based on their track record, we would not expect the cable industry to change their attitude toward the rural consumer if they were given free reign to establish an MSO-controlled DBS system.

We refer you to Attachment E concerning the plans of this potential cable consortium. We realize that this situation is speculative, but we believe that the threat to competition in media access through this potential MSO move is significant.

Summary

We are pleased to have presented this report to you, Mr. Chairman and Subcommittee members. We have been involved in this industry since 1984 and have been able to market a programming package only after many fights in which Congress has been particularly supportive and helpful. I am proud of what the rural electric and rural telephone members of NRTC have done to support rural Americans. And I am thankful for Congress' support so that we may bring rural consumers' interests to this public hearing.

As I have stated and have supported by example, we believe that the home satellite dish industry is not working. And we believe that Congress is the key forum where this young industry with great potential can look for fair treatment and remedies of the many problems that are causing its instability.

Our experiences show that the HSD market is not a favored distribution outlet in the program distribution industry. Unless it can be controlled, the delivery of programming to the HSD and future DBS markets pose a problem for the cable industry which has worked to gain the lion's share of all current and future video markets. And Mr. Chairman, the lion's share is all of it.

We believe that large and powerful cable MSOs and cable programming services are working to protect themselves from competitors like NRTC and competing technologies such as Ku-band, DBS and fiber optics.

We hope that the Subcommittee will look at several avenues of support for the HSD market. It was only a few short years ago that Congress provided the cable industry protection from the large and powerful broadcast industry. That boost by Congress was instrumental in the success cable experiences today. Without Congressional assistance, the competitive battle between broadcasters and cable would have raged-on long and hard. Much strength, energy and resources would have been diverted from the development of cable and it is unlikely that cable would have achieved its current level of success.

The home satellite dish market needs that same kind and gentle support from Congress. I would like to propose several actions for your consideration that I believe protect the HSD market from the undermining activities of cable and would give the HSD market a chance to become a strong competitor to cable, just as cable is strong competition to broadcasting. They are:

*Establish laws which mandates in technologically-neutral terms, conditions and pricing for programming;

*Make programming access equally available to qualified entities, regardless of the method of distribution at the retail level;

*Direct the FCC to refocus its attention on the national goal of providing universal access to information;

*Consider banning or limiting the ability of cable entities from participating in the nascent DBS market, just as cross-ownership restrictions were adopted to promote diversity of ownership in other telecommunications technologies.

Mr. Chairman and Subcommittee members, more than 50 years ago the Federal government created the Rural Electrification Administration, popularly called the REA. The REA supported rural communities in a national effort to bring the comforts of electricity to the sparsely settled farms and homes of the nation. The REA worked hand-in-hand with people at the local, rural level who built an electric utility system that investor owned organizations would not.

The growth of rural electric service was done in an orderly way, with an emphasis not on control or large profit but on establishing a sound infrastructure of service on which to base future growth. The outcome is a glowing example of the opportunities for a public-private partnership of service. Life in the country has been dramatically improved by these unselfish action. Universal access to electric service became a reality.

Then the REA worked in a public-private partnership to provide the next critical area of needed service in rural America. It supported the development of universal telephone service in rural areas which was achieved in the local communities. Again, life in the country was dramatically improved.

Our society is now driven by the information age. Access is critical. But rural areas will not have that access through cable. Satellite delivery is essential to rural America's access to video programming.

I am not asking today for Federal aid such as that provided by the REA. I am not asking for preferential treatment for NRTC. I am simply asking that the government act as the arbiter of fairness in the development of the HSD market so that stability and affordability replace confusion and anger. Our experiences indicate that the high degree of ownership concentration in media has been an impediment to the orderly development of a technology ideally suited to the rural reaches of this great nation. That problem must be fixed.

Thank you, Mr. Chairman and members of the Subcommittee for your time and attention.

Senator **Inouye**. I can just sense the adrenaline flowing in Senator Gore.

Senator **Gore**. It is true.

Senator **Inouye**. Our next witness is the Vice President of the National Economic Research Associates, Mr. Harry Shooshan.

STATEMENT OF HARRY M. SHOOSHAN III, VICE PRESIDENT, NATIONAL ECONOMIC RESEARCH ASSOCIATES, INC.

Mr. **Shooshan**. Thank you, Mr. Chairman.

As you mentioned earlier, and I wanted to reiterate, I am here at the request of the U.S. Telephone Association, the association that represents all telephone companies from the largest Bell operating companies to the smallest independents.

On behalf of USTA I would like to say that we commend the committee for holding these hearings and thank you in particular, Mr. Chairman, for the opportunity to be here today.

Having said that, I should also it clear to members of this subcommittee, that the positions that I take today in my discussions with you are not necessarily those of USTA.

Moreover, I should say that as Vice President of National Economic Research Associates, the positions that I take are not necessarily those of NERA and, in fact, I might say, as you can expect with a large group of consulting economists, there are probably people in NERA who would not agree with some of what I might say here today.

With those caveats, however, Mr. Chairman, I want to say that I am here really because of the fact that all my adult professional life, including 10 years as a House staffer where I had the opportunity to work with then-Congressman Gore as chief counsel to the House Communications Subcommittee, the last eight and a half years as a lawyer and consultant working in both the cable and now the telephone industry, and the last 11 years as an adjunct professor at Georgetown Law School, I have spent working on these particular issues, and it is that perspective or at least part of that that I wanted to share with the subcommittee this morning.

The legislation pending before the Congress and, in fact, the complaints that you are hearing from people who are concerned about cable's market power pose really two options to the Congress. On the one hand there is the option of reregulation. That is being discussed, and it has been mentioned here this morning.

Another option is laid before the Congress and that is the option of ensuring competition.

I want to talk in the time that I have this morning about that choice, that dichotomy, the choice between addressing these problems through reregulation and addressing them through ensuring or enhancing competition.

Now, let me say before I start that discussion that I think it is important to understand what we mean when we say reregulation.

I think there are concerns about structural regulation, and for the most part those are the kinds of issues that INTV and others have raised here today about the possibility of regulation that deals with the structure of the cable industry, availability of programming, must carry status for broadcasters.

I have addressed those issues—questions of structural regulation of cable—in a paper that has been supplied to the committee which I had the opportunity to write at the end of last year. It is just being published I understand this month by Duke University Press, written for the Markle Foundation project in communications policy, and I would suggest with all due respect to Mr. Mooney who said that there are not enough facts out on the table on these issues, there are some facts in this study, and I would commend them to you for your consideration.

But the structural issues I think you have heard a lot about today. What I would like to talk about is the choice that you have between economic regulation of cable; that is, the reimposition of economic regulation on cable, and the introduction of competition, and there very strongly I commend to this subcommittee that the course that you need to take is to induce competition.

The failure, if there is one, in the 1984 Cable Act was that people anticipated that a competitive marketplace would develop faster and more extensively than it did, and the fact is it has not in large part because people made bad predictions about new technology, but also in large part because of some anticompetitive practices on the part of the cable industry.

Let me say what I think are the consumer benefits that come by promoting competition in this market rather than reregulation, and I am talking again about economic regulation.

Competition, it seems to me, much more than economic regulation will ensure that prices more accurately reflect the costs of service provision.

Two, competition will encourage the rapid development of new technology. Fiber, if telephone companies are permitted to enter this market, and there I would note that legislation sponsored by Senator Gore, Senator Gorton, and Senator Ford, also a member of this committee, would, subject to safeguards, permit that to happen; that is, telephone companies to enter; that deployment of new technology, whether it is fiber, whether it is satellite or whether it is microwave in the case of MMDS, will occur more quickly if the policy that we choose is competition.

I think that it will also lead, competition will, to a more rapid introduction of new services, switched video, interactive broad band services and the like that will give consumers more options than they have today.

Third, competition will encourage more rapid response to consumer demands regarding quality and service, two big complaints that I suspect many of you have heard about the current cable service that is out there, and that response will occur, more rapid response will occur as firms, competitive firms seek to differentiate their products.

Now, customer service will become something people compete to provide and not something now that people deign to provide when pressured by political forces.

And fourth, competition is feasible in this market. Potential competitors exist today, and they would be able to enter niche markets quickly. I think wireless cable is a perfect example of that.

Pervasive competition, competition that could come by a competing provider of, in effect, wire line service from, for example, the telephone companies, is feasible in the longer term.

The flip side of the coin that I am presenting to you today is that a regulated cable monopoly will not benefit consumers. My view is the traditional economic regulation is there to mimic what a competitive market would provide if competition were feasible.

But in this case, as I said, competition is feasible, so we do not need to reimpose economic regulation. A regulated monopoly market structure tends to discourage innovation and introduction of new services and moreover, regulation, economic regulation, reduces the incentives to cut costs and can result in inefficient rate structures.

Now, if one thing that I have learned in ten years working as a staffer on the Hill and the last eight and a half years working in this environment in Washington, there are immediate problems that you are faced with.

You are all hearing, as you have indicated this morning from constituents who are concerned about rates, and I think the answer to Senator Pressler's constituents or any of the others, Senator Gore's, to say well, pervasive competition will come at some point down the road, so we can just hold off for that. That may not be adequate.

And so after having said that my own biases are in favor of inducing competition, that is really what government should be doing instead of reimposing economic regulation, I realize that Congress may in its wisdom decide that some interim form of regulation is desirable in order to protect consumers.

If you find that regulation, economic regulation is absolutely necessary, then I would urge you not to return to the regulatory environment that existed prior to the 1984 Cable Act. I do not think even the cities, and I just came from a meeting of the Conference of Mayors in Charleston where they have endorsed the idea of competition first and regulation as a last resort—I do not think even the people who used to be in the business of economic regulation of cable really want to be back in that business now if competition can solve the problem.

Instead I think that any reregulation that occurs should be designed to address the current problems resulting from unregulated cable monopoly.

Senator Kerry when he was here earlier came close to, I guess, scooping the suggestion that I would make to you, if you find that reregulation, economic reregulation is necessary.

He asked about price caps, capping the cable rates. What is interesting is that that same idea has been broached by Dr. Malone and others in the cable industry and of course when I begin to hear someone who has monopoly power talking about capping rates at current monopoly levels, I get a little nervous about that.

So if Congress wants to reimplement price regulation, it should do so only after rolling back rates to their pre-deregulation levels. For example, the second quarter of 1986 would be a good benchmark to use.

I think that placing limits on rates charged by cable operators in this fashion will truly safeguard consumers against monopoly pricing until cable rates can adequately be constrained by competition.

So, if you must act, at least do not take the beguiling suggestion that the cable industry might come forth with that we ought to do rate caps at current levels. I think you really want to look seriously about a rollback and then some form of rate cap until competition can effectively and pervasively exist in most markets.

Thank you, Mr. Chairman, again for the opportunity to be here today.

Senator **Inouye**. Our final witness is the legislative director of the Consumer Federation of America, Mr. Gene Kimmelman.

STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. **Kimmelman**. Mr. Chairman, members of the subcommittee, on behalf of the Consumer Federation I appreciate this opportunity to express consumer concerns about horizontal concentration and vertical integration in the cable industry.

At the outset, Mr. Chairman, I would like to respond to your comment that the subcommittee would not act precipitately. You mentioned to Mr. Mooney before, our organization did not support the 1984 Cable Act. We thought there were major problems with it that would arise.

We did not come back in 1985. We did not come back to the Congress in 1986, in 1987 or in 1988. But I must tell you, I do not believe it is precipitous to come back in 1989 and say that it is time to revisit the Cable Act.

Competition has not developed. A few large cable companies have expanded horizontally, buying up other cable operating systems, and vertically buying into major sources of television programming, and the result is a growing horizontal concentration tied to a vertically integrated web of cable operating and programming interconnections which is building monopoly power in the cable industry

Our data show that if cable were still price regulated and prices were aligned with the actual cost of providing cable service and discriminatory practices that have been mentioned by this panel were outlawed, consumers' cable rates would be about one half of what they are today, saving the public about $6 billion.

We believe it is time for some modest mid-course corrections to the Cable Act to promote competition and make cable affordable to all Americans.

Mr. Mooney described this as a dispute over who gets to keep the margin. $6 billion in the video industry is a very big margin, and there may be concerns among you as to which entrepreneur gets that margin, but I would think the greater concern is why should the consuming public be overcharged for this service in the first place?

How did this happen? Who was the culprit? Well, we believe it has really been a confluence of events that led us to such significant problems with the cable industry today and it is imperative for the Congress to step in to rectify these problems now.

First, cable deserves credit for what it has done. It has really been a success. It is providing a package, and I emphasize package, of programming that goes way beyond the networks that the American public was accustomed to.

It provides network broadcasting. It provides independent stations. In addition, it provides valuable educational, cultural, sports and entertainment programming that increasingly the American people want, care about and view as essential. All surveys show this.

But since this is a package that goes way beyond the networks, a package of programming that is so attractive to the public, any small portion of this package is not a competitor to cable television. It is a different product. It is a different service.

The networks can no longer compete with cable. They are two different markets. Yet we have the FCC deregulating cable television rates, making it impossible for local municipalities to regulate cable rates for any system where consumers receive free, over-the-air signals.

This is described as effective competition. This is clearly a mistake. It is a backwards policy. It is not looking at the cable market and the video market as it exists today and this needs to be corrected.

The public clearly believes that basic cable is what they want, is what is essential to their daily viewing needs. The result of this deregulation is cable rate increases for basic cable services that run two to three times the rate of inflation in our economy, compared to during the era of reregulation, rate increases of less than the inflation rate, most often not even two-thirds the rate of inflation.

Simultaneous with this deregulation, we have the Justice Department closing its eyes to the dangers of horizontal concentration and vertical integration, allowing the development of a very intricate web of financially connected cable companies that first have strong incentives to favor the programming of their affiliated programmers—and by the way, Dr. Klein's study, mentioned before by Mr. Mooney, verifies this point.

This web of cable operations has incentives to pressure nonaffiliates not to carry the programming of their competitors, and this ownership web gives the cable companies and their affiliated programmers the opportunity to prevent noncable competitors from getting access to programming that is necessary to compete with cable, as you have heard from members of this panel.

The result is a combination of these developments together—not any one of them, not just vertical integration, but the entire combination of these factors—has resulted in excessive basic cable rate increases, discrimination against potential competitors to cable, and denial of popular programming to the public based on the financial self-interest of cable companies that own programming.

In conclusion, Mr. Chairman, we believe it is time for Congress to put an end to this overpricing of cable service and discrimination against entities that could discipline cable's marketplace behavior. A little regulation now would save cable viewers a lot of money and enhance viewing options down the road. We urge you to tackle this problem head-on as an immediate priority.

In reference to Mr. Shooshan's point on telephone company entry, I just must add that from the consumer perspective we believe that there are greater risks that would be added to phone company entry with the potential of cross-subsidization, a potential of basic telephone rate increases, than benefits of any duopoly to company wires providing video services.

We urge you to clean up the cable industry first. Clean up the Cable Act first, before considering teleco entry into cable.

Thank you.

[The statement follows:]

STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

The Consumer Federation of America (CFA)1/is deeply concerned that concentration, vertical integration and inadequate regulation of the cable television industry have driven up the price of cable services beyond reasonable levels and threaten to reduce diversity of programming. Unless Congress reinstates regulation of basic cable rates and prohibits anticompetitive discrimination by the cable industry, television viewers will remain overcharged and underserved.

A POLICY VOID IS RESULTING IN EXCESS CHARGES OF BILLIONS OF DOLLARS FOR THE VIEWING PUBLIC

The cable industry is rapidly coming to dominate one of America's most important entertainment and cultural activities, television viewing.2/ Because this service is provided by an increasingly concentrated oligopoly of companies disciplined neither by competitive market forces nor by government regulation, consumers are being ruthlessly overcharged for cable television viewing. If the industry were composed of vigorously competitive, independent entities at all three of its stages -- production, programming and distribution -- consumers would be paying no more than half of what they are charged today for cable services.

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1 Founded in 1968, CFA is the nation's largest consumer advocacy group, composed of over 240 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power and cooperative organizations.

2 On the political and cultural importance of the media see Peter L. Kahn, "Media Competition in the Marketplace of Idea," 39 Syracuse L. Rev. 737 (1988) and Testimony of George E. Garvey, Subcommittee on Economic and Commercial Law, Committee on the Judiciary, U.S. House of Representatives, March 14, 1989, p. 5.

The problem of inadequate competition and excessive rates has emerged and is growing worse on an almost daily basis because of fundamentally inconsistent and irrational federal policies.3/

As a starting point, the federal government virtually stripped local governments of the ability to regulate the cable industry in the Cable Communications Policy Act of 1984.4/ Cable franchises have developed into nearly perpetual, exclusive monopolies beyond the regulatory control of local governments.

At the same time, the federal agencies which were supposed to protect consumers have failed to do so. The Federal Communications Commission (FCC) has incorrectly applied a grossly inadequate definition of competition to the industry.5/

Even though surveys demonstrate that consumers value and choose cable because of specialized movie, sports adult and cultural programming,6/ the FCC defines the cable market as competitive where no alternative cable systems or equivalent programming packages provided by other transmission technologies are available and no similar specialized programming is accessible. Cable rates are deregulated because, according to the FCC, competition exists where consumers can receive three networks and no specialized programming over-the-air. Perceiving competition where it does not exist, the FCC has refused to regulate cable rates in almost all instances or to trigger the

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3/ Glenn B. Manishin, "Antitrust and Regulation in Cable Television: Federal Policy At War with Itself," Cardozo Arts & Entertainment Law Journal, 6:1 (1987).

4/ Cable Communications Policy Act of 1984, 47, U.S.C. S521-59.

5/ Commission's Rules to Implement the Provisions of the Cable Communications Policy Act of 1984, 50 Fed. Reg. 18637-18660 (1985).

6/ Consumer Reports in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, p. 244; The Roper Organization, America's Watching The 1989 TIO/Roper Report (1989), p. 4.

power of local governments to regulate.

Meanwhile, the Department of Justice, which has primary responsibility for ensuring the workability of market forces through implementation of the antitrust laws has declared that the industry is a monopoly at the local level.7/ Since monopolists cannot be said to engage in collusion (they have no one to collude with), this aspect of the federal antitrust laws has been rendered dormant. The Department of Justice has also refused to enter the field with vigorous antitrust enforcement against either horizontal concentration or vertical integration.

The black hole of public policy that results is a monopolist's dream world and a consumer's nightmare. Regulated neither by market forces nor by government bodies, the cable industry is now dominated by a small group of vertically integrated, financially interconnected companies that have continually expanded their market power over production, programming and distribution, foreclosed competitors and driven prices up.

CONDITIONS FOR THE ABUSE OF CABLE INDUSTRY MARKET POWER

Once the Cable Act turned local franchises into the virtually irrevocable personal property of incumbent cable firms, the fate of consumers was left to federal authorities to either foster and protect fledgling competition in the industry or regulate monopoly power. Unfortunately, the federal authorities have done neither and the breakdown of governmental oversight has opened two primary avenues for abuse.

7/ Manishin, op. cit., p. 606. The courts have been ambivalent about the antitrust implications of the local monopoly -- see Central Telecommunications v. TCI Cablevision, 800 F.2d 711 (8th Cir. 1986) (antitrust action is allowed on grounds of preventing competitive entry; H.R.M. Inc. v. Tele-Communications, Inc., (Civ. A. No. 86-A-2534) (subsidiaries cannot collude with parents); Friedman v. Adams Russell Cable Services-New York (624 F. Supp. 1195 (S.D.N.Y. 1986) (monopolist cannot harm competitors).

Cable operators who control access to a large part of the viewing public (multiple system operators [MSOs]) can extract concessions from programmers who desperately need to reach a large audience. Because they have market power over consumers, the MSOs pocket these concessions as excess profits, rather than passing them through to consumers. They exercise their monopsony power vis-a-vis programmers and their monopoly power vis-a-vis consumers.8/

Monopoly power can be exercised by companies that control the supply of very popular or extensive packages of television programming. These powerful programmers can extract concessions from all but the largest cable operators, who rely on these important programs to attract subscribers, by manipulating prices and program availability to cable operators. Again, because of market power at the point-of-sale, the costs of these anticompetitive strategies are passed forward to consumers.

Theoretically, one may hypothesize a set of conditions in which this bilateral monopoly is in the public interest, but this has not been the recent experience in the cable industry. The

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8/ Sylvia M. Chan-Olmsted and Barry L. Litman, "Antitrust and Horizontal Mergers in the Cable Industry," Journal of Media Economics, Fall, 1988, p. 9-10; James A. Ordover and Yale M. Braunstein, "Does Cable Television Really Face Effective Competition?," in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, p. 574. Christine Ammer and Dean S. Ammer, Dictionary of Business and Economics (New York: The Free Press, 1984), p. 305, define monopoly and monopsony together as follows.

> Monopoly, monopsony: Exclusive control over a particular product or service by one seller (monopolist) or one buyer (monopsonist). The terms also apply to groups of sellers or buyers who can exert such control through mutual agreement. The monopolist's essential advantage is the absence of competitors, enabling a firm to control the supply of its commodity so as to obtain the highest possible profit. Similarly, the monopsonist, as the only buyer, can control purchases so as to obtain the lowest possible price.

shared interest of cable operators and programmers in maximizing profits (producer surplus) and inflating cable rates (minimizing consumer surplus) proved too strong.9/ Instead of competing away the monopoly and monopsony profits by encouraging the entry of competitors into both programming and cable operations, these two functions have become integrated, thereby freezing out independent competitors.

Without comparable viewing packages available to the public, competitive market forces are not strong enough to pressure hard bargaining between independent cable operators and programmers or to threaten integrated programmer/operators with loss of market share sufficient to drive prices down.10/ The integrated companies actively seek to reinforce their market power in programming and the monopoly at the point of distribution, enhancing their ability to maximize producer surplus. In the cable industry, vertical integration has been combined with horizontal concentration and a vigorous campaign of anticompetitive actions to ensure market power at the point-of-sale.

> Thus, for example, through vertical integration MSOs may deny programming to

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9/ Although the recent attitude toward vertical integration has been to presume that it is efficiency enhancing, a strong set of counter arguments is emerging, particularly as it affects the cable industry. See Thomas G. Krattenmaker and Steven C. Salop, "Anticompetitive Exclusion: Raising Rivals' Cost to Achieve Power Over Prices," The Yale Law Journal, 92:2 (1986); and J. A. Ordover, A. O. Sykes, and R. D. Willig, "Nonprice Anticompetitive Behavior by Dominant Firms Toward the Producers of Complementary Products," in Franklin M. Fisher (Ed.), Antitrust and Regulation (Cambridge: MIT Press, 1985).

10/ The importance of taking these types of arrangements into account in assessing the effects of market structure has been emphasized in the context of merger analysis. See J. A. Ordover, A. O. Sykes, and R. D. Willig, "Herfindahl Concentration, Rivalry, and Mergers," Harvard Law Review, 95 (1982).

> alternative cable technologies such as MMDS ("wireless cable"), which constitute a head-on threat to cable's control of the local market. Such anti-competitive tactics are easier to carry out when a distributor (a large MSO, for example) also owns an important programming source. In addition, as the MSO becomes larger, the more credible become its threats to disadvantage the program vendor at the distribution level if it refuses to cooperate with the distributor's programming tactics. Such a disadvantage could be produced, for example, by placing the vendor's program on a high channel where it is less likely to be viewed by subscribers, or by refusing to carry the service. Other tactics could include overpricing a particular program or not including it in the optimal tier.[11]

HORIZONTAL CONCENTRATION, VERTICAL INTEGRATION AND JOINT VENTURE INTERCONNECTION ARE SPREADING RAPIDLY IN THE CABLE INDUSTRY

The largest cable operator, Tele-Communications Inc. (TCI), now accounts for almost one quarter of the market.[12] This does not take into account its close association with the fourth largest firm (Comcast Cable Communications) through joint ownership of an entity that would be the sixth largest operator (Storer Cable Communications) if it had an independent existence (Comcast and TCI also overlap in a large basic program service, QVC Network). If this group is considered together, the dominant firm controls almost one-third of the market (a 30 percent market share).13/

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[11] Ordover and Braunstein, op. cit., p. 574.

[12] Testimony of Jack Valenti, President, Motion Picture Association of America, Subcommittee on Telecommunications and Finance, United States House of Representatives, May 11, 1988; see also CableVision, Top 100 MSO's; Article entitles "Cable Rate Hikes Spreading," in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988.

The second largest firm (Time Inc., owner of American Television Communications [ATC]) has proposed to merge with the sixth largest firm (Warner Cable Communications) and press accounts indicate that these two have jointly acquired the nineteenth largest firm (Centel Communications). This group represents over one-seventh of the cable market (a 14.5 percent market share).14/

TCI has followed a strategy of first dominating the cable operators market and then expanding backward into programming. It doubled its market share after deregulation through acquisitions.

> TCI and other operators are big shots in their franchise areas because theirs is usually the only game in town. Operators don't have direct competition, and they have been able to set their own rates since January, when the industry was deregulated. Operators own the hardware -- cable and overhead wire -- that feeds the software, or programs, to subscribers' homes. An operator can break a local low rate station, especially a public or independent broadcaster, by refusing to carry its programs. Local subscribers see only the national services operators choose to buy, such as Christian Broadcast Network, the Spanish-language Univision, Inc. programs, kid's shows on Nickelodeon, the Black Entertainment Television Network, or Arts & Entertainment Network.
>
> But Malone is more formidable than any other cable operator because it's virtually impossible to

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13/ The importance of considering the reactive behavior of rivals has been stressed in the antitrust context by Richard Schmalensee, "Another Look At Market Power," Harvard Law Review, 95:1982; Janusz A. Ordover, Alan. O. Sykes and Robert D. Willig, "Herfindahl Concentration, Rivalry and Mergers," Harvard Law Review, 95:1982; Louis Kaplow, "The Accuracy of Traditional Market Power Analysis and A Direct Adjustment Alternative," Harvard Law Review, 95:1982 Ordover,

14/ Valenti, op. cit.

> make money from a cable network without TCI's 8 million subscribers. Indeed, Malone's support has launched fledgling networks, and his opposition has kept other from getting off the ground.15/

Time's strategy appears to be taking the opposite path.16/ Its market power results from its ownership of the number one and number four ranked pay services (HBO and Cinemax respectively) and the second largest cable operator (ATC). Time alone accounts for approximately 45 percent of the pay service market.

Thus, we have one firm (TCI) dominating the operator segment and integrating up-stream into programming. We have a second firm (Time) dominating the programming segment and integrating down-stream into cable operations.

The two dominant firms are also thoroughly interconnected through a series of joint ventures. With independent sources of market power, they can avoid competing head-to-head in the marketplace by maintaining exclusive franchises and exclusive distribution of programming. With this basic structure, joint ventures become a mechanism for enhancing market power and creating ever larger barriers to entry for other potential competitors.17/ The task of mounting a simultaneous entry at the level of programming and cable operation becomes ever more formidable as the joint ventures proliferate more specialized programming while dividing the marketplace around specific franchises and programming.

15/ "The King of Cable," Business Week, October 27, 1987, p. 111.

16/ Time's dominant position in programming and its leading role in the effort to prevent the entry of TVRO suppliers, as well as to provide overbuild insurance, not to mention its greater tendency to refuse to deal and discriminate, indicate its preference for this strategy.

17/ Krattenmaker and Salop, op. cit., pp. 238-240.

As we learned from airline deregulation, creating networks can establish formidable barriers to entry.18/ Similarly, the integration of programming and cable operations poses a barrier in the cable industry. We know that the airline industry is not even contestable, not to mention competitive.19/ One cannot simply buy or rent a plane (or threaten to) and enter markets at will. One must have landing slots and gate space at both ends of the route and fair access to the stream of passengers who would like to make the trip to successfully enter. Similarly, one must have access to quality programming at competitive rates and potential subscribers if one is going to enter the cable business. Vertical integration and joint ventures make this task increasingly difficult.

TCI and Time also exert their market power through multiple interconnections of ownership shares. TCI and Time each hold interests larger than 5 percent in Cable Value Network, the Fashion Channel, Black Entertainment Network, Cable New Network, Turner Broadcasting and Headline News (see Exhibit 1). TCI is

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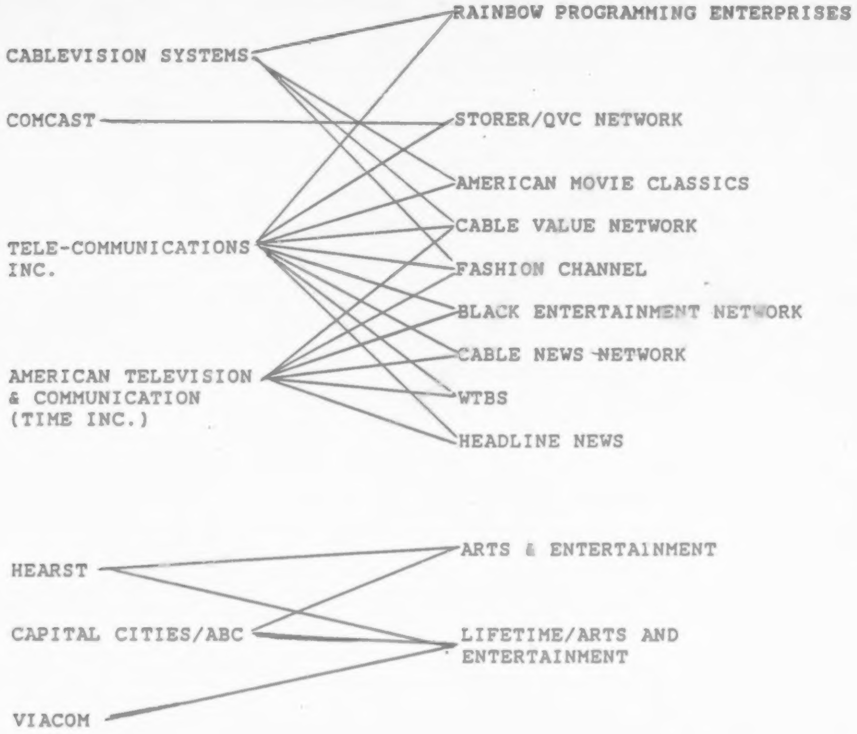
18/ Chris Welles, "Is Deregulation Working?" Business Week, December 22, 1986, raises the issue of networks. M. E. Levine, "Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy," Yale Journal of Regulation, 4, 1987, points out that virtually no one foresaw the immense importance of hub and spoke organization. He points out numerous other failures of both the competitiveness or contestability models to describe the airline industry.

19/ Contestability theory held that if entry and exit from an industry were completely costless, the mere threat of entry would discipline the incumbent firms. Even if only one firm were in the market, it could not behave as a monopolist. This theory has been thoroughly discredited. Empirical tests of the theory in the airline industry, which was supposed to be the quintessential case of contestability, consistently reject the theory. See S. Morrison and C. Winston, The Economic Effects of Airline Deregulation (Washington, D.C.: Brookings Institution, 1986), Chapter 6; E. E. Bailey, D. R. Graham and D. P. Kaplan, Deregulating the Airlines (Cambridge: MIT Press, 1985) Chapter 9; D. R. Graham, D. P. Kaplan, and D. S. Sibley, "Efficiency and Competition in the Airline Industry," Bell Journal of Economics 14, 1983.

EXHIBIT 1:

JOINT VENTURES IN PROGRAMMING AMONG MAJOR CABLE INDUSTRY FIRMS


CABLEVISION SYSTEMS
COMCAST
TELE-COMMUNICATIONS INC.
AMERICAN TELEVISION & COMMUNICATION (TIME INC.)
RAINBOW PROGRAMMING ENTERPRISES
STORER/QVC NETWORK
AMERICAN MOVIE CLASSICS
CABLE VALUE NETWORK
FASHION CHANNEL
BLACK ENTERTAINMENT NETWORK
CABLE NEWS NETWORK
WTBS
HEADLINE NEWS
HEARST
CAPITAL CITIES/ABC
VIACOM
ARTS & ENTERTAINMENT
LIFETIME/ARTS AND ENTERTAINMENT

NOTES AND SOURCE: Only joint ventures are shown, wholly owned programs are not shown, but are counted in Exhibit 2 in the appropriate column. "Testimony of Jack Valenti, President of the Motion Picture Association of America," *Subcommittee on Telecommunications and Finance, Energy and Commerce Committee, United States House of Representative*, May 11, 1988; "Vertical Integration," in *Competitive Issues in the Cable Television Industry*, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 416-417.

interconnected with Comcast in both the Quality Value Network and Storer Cable Communications. It has multiple interconnections with Cablevision Systems in American Movie Classics and Cable Value Network, as well as the Fashion Channel. The latter two overlap with the Time's ownership interests.

With the pending merger of Time and Warner and proposed acquisition of Centel, this becomes a thoroughly dominant interconnected set of companies, led by the two largest in the industry -- one rooted in programming, the other in cable operations (see Exhibit 2). This group accounts for 47 percent of all subscribers, 23 percent of all basic service subscriptions and 67 percent of all pay services (including both monthly pay service and pay-per-view service).

Based on this view of the industry, the Time/Warner merger fails even the lenient test of excessive concentration used by the Department of Justice.19/ When viewed at the local level, the impact of that merger on even a very large market like the New York metropolitan area is worse.20/

Other cable operators are touched by this web of interconnections. Interestingly, the equity ownership of

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19/ The Hirschman-Herfindahl Index (HHI) is used by the Department of Justice in its Merger Guidelines to assess the impact of mergers). For cable operations at the national level HHI is about 900 when joint ventures are not taken into account. Adding the Time/Warner merger raises it by about 60 points, which does not trigger DOJ scrutiny. However, arguing that the interconnections between the firms reinforces their mutuality of interests and enables them to effectuate reinforcing rather than rivalrous behavior (as per the sources cited in note 13 above), the pre-merger HHI rises to well above 1900. Warner is not tied into this web by equity ownership above five percent. Adding the merger to the interconnected web of companies raises the HHI over 200 points. This fails the Merger Guidelines test.

20/ The Comment of New York State Consumer Protection Board in the Time/Warner Merger, April 5, 1989 demonstrated a much higher level of concentration in the New York City metropolitan area.

EXHIBIT 2:

NATIONAL MARKET SHARES OF MAJOR INTERCONNECTED COMPANIES IN CABLE SYSTEMS, BASIC SERVICE AND PAY SERVICE PROGRAMMING

COMPANY	CABLE SUBSCRIBERS (000,000)	BASIC SERVICE SUBSCRIBERS (000,000)	PAY SERVICE SUBSCRIBERS (000,000)
CABLEVISION SYSTEMS	1.0	1.7	6.3
TELE-COMMUNICATIONS INC.	10.8	26.0	0
AMERICAN TELEVISION & COMMUNICATION (TIME)	4.5	0	23.9
WARNER	1.4	0	0
COMCAST	1.4	0	.2
JOINT VENTURES	2.0	186.0	10.3
TOTAL 5 COMPANIES	21.1	212.0	40.7
VIACOM	1.1	162.3	11.6
HEARST	.1	0	0
CAPITAL CITIES/ABC	0	48.8	0
JOINT VENTURES	0	65.4	0
TOTAL 3 COMPANIES	1.2	265.5	11.6
NATIONAL TOTAL	44.7	930.0	60.1
5 COMPANIES AS % OF NATIONAL TOTAL	47.2	22.7	67.4
3 COMPANIES AS % OF NATIONAL TOTAL	2.7	28.5	19.3

SOURCE: "Testimony of Jack Valenti, President of the Motion Picture Association of America," Subcommittee on Telecommunications and Finance, Energy and Commerce Committee, United States House of Representative, May 11, 1988; "Vertical Integration," in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 416-417.

programming joint ventures which is allocated according to subscribers tends to reinforce the market power of the dominant firms.21/

There is a second interconnected series of companies that hold overlapping ownerships of ESPN (Capital Cities/Viacom) and Lifetime/Arts and Entertainment (Viacom/Hearst). This smaller group accounts for two percent of cable subscribers, but 27 percent of all basic subscriptions and 19 percent of pay service subscriptions.

Combining these two groups we find that about a half-a-dozen firms account for over 50 percent of subscribers, 50 percent of all basic service subscriptions and almost 90 percent of all pay for service programming.

COMPETITION FOR CABLE IS WEAK AND HAS BEEN FORECLOSED BY THE ANTICOMPETITIVE PRACTICES OF THE CABLE INDUSTRY

Head-to-head competition -- two cable wires passing each home -- was promised at the time of deregulation, but has failed to materialize.22/ Only about one-in-two hundred cable operators faces any direct cable competition and an even smaller percentage of subscribers enjoys the consumer benefits of such competition.23/

Many existing cable operators, in concert with their

21/ Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 113-116.

22/ Subcommittee on Communications, Committee on Commerce, Science and Transportation, United States Senate, 99th Congress, 1st Session, February 16-17, 1983.

23/ "Testimony of Gary R. Chapman, on Behalf of the National Association of Broadcasters," in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, p. 525.

programmer-owners, have engaged in vigorous anticompetitive actions to prevent head-to-head competition (which is described pejoritively by the industry as "overbuilding"). Potential competitors have been thwarted by cable operators-programmers denying them access to consumers and programming or by overcharging for or restricting the use of programming that is made available.24/

A similar pattern typifies the response to close substitutes. Competition from close substitutes could be provided by proven technology like wireless cable, which has a multi-channel capacity that begins to approach that of cable, or TVRO (satellite dish) services. These have been squelched by a variety of tactics. Outright refusals to deal and exclusivity arrangements for programming have limited the ability of these near competitors to offer services that are comparable.25/ Discriminatory pricing or terms of service undercut the competitive viability in other instances.26/

24/ The concern about overbuilding among MSOs and some of the efforts to prevent it are mentioned in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 152-157.

25/ Testimony of Mark Foster, Chairman, Microband Companies Incorporated Wireless Cable of New York, before Charles Schumer and Richard Kessell, March 6, 1989, p. 3; Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 118-122, 127, 152-174.

26/ "Testimony of Mark Foster, Chairman and CEO of the Microband Companies Incorporated," in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 388-403. Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 118-122.

HBO's effort to offer overbuild insurance is a revealing example, as recently described in the Hart-Scott-Rodino filings of the New York State Consumer Protection Board in the Time/Warner merger.

> Under that plan, HBO exclusivity would only be available in areas where overbuilds (head-to-head competition) had not occurred. This effort clearly suggested a desire to prevent entry of competitors at the distribution level.
>
> The plan further tied the exclusive rights to HBO to two of Time's less popular products, Cinemax and Festival. It also explicitly attempted to tie distributors to HBO since affiliates who were offered exclusivity "may not hold exclusive cable rights for any other pay or basic programming service whose programming consists primarily of theatrical films."
>
> The proposal was explicitly and selectively anti-competitive, intended to prevent overbuilding. Justified as an effort to promote "an effective environment for the long term growth of our programming services," the problem with overbuilds was seen as a disincentive for local operators "to market and promote our services."27/

Competition from near substitutes has also been impeded. Time Inc., parent of HBO, was also in the forefront of the effort to prevent TVRO operators from gaining access to programming.28/

27/ Consumer Protection Board, op. cit.; John Wolf, "Cool Response to Exclusivity Offers," in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, p. 157; Debbie Harrod, "Rainbow Offers Ops Exclusivity Contracts," Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, p. 156.

28/ Chan-Olmsted, op. cit., p. 11.

Virtually all of the major programmers deny access to or discriminate against "wireless cable" operators in provision of programming.29/

In a recent study of programming, the NTIA argued that integration does not affect the programming available to subscribers.30/ That conclusion is at odds with more rigorous analysis and, in fact, with the NTIA's own data.31/ NTIA reached the wrong conclusion because its analysis included some rather small integrated systems and did not focus on the two different bases of market power we have identified or the multiple interconnects between groups of companies.

The NTIA data show that Time Inc.'s affiliate, ATC, clearly has discriminated against the programming of its major rival, Viacom (see Exhibit 3). ATC was more likely to carry its own programming -- all four programs were more likely to be carried by its affiliates than non-affiliates.32/ At the same time, ATC's affiliates were less likely to carry one of three of Viacom's programs than non-affiliates. Viacom affiliates were more likely to carry two of its own three programs.

The differences in the percentage of stations carrying the competing programmers' offerings are quite large, with the exception of HBO, which is the overwhelmingly dominant pay

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29/ Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 118-122.

30/ National Telecommunications and Information Administration (NTIA), Video Program Distribution and Cable Television: Current Policy Issues and Recommendations (U.S. Department of Commerce, June 1988), Chapter 6.

31/ Michael Salinger, A Test of Successive Monopoly and Foreclosure Effects: Vertical Integration between Cable Systems and Pay Services (Graduate School of Business, Columbia University, September 1988).

32/ The text mentions only statistically significant differences. The table shows the direction of all differences. It should come as no surprise that Viacom recently filed an antitrust lawsuit against Time for $2.4 billion alleging that Time and its affiliates HBO, ATC and Manhattan Cable have engaged in anticompetitive conduct designed to entrench themselves as monopolists, injuring competition and consumers.

EXHIBIT 3:

TENDENCY OF MAJOR INTEGRATED PROGRAMMERS TO CARRY RIVAL PROGRAMS

		AFFILIATES PROBABILITY OF CARRYING PROGRAMMING	
		ATC AFFILIATES	VIACOM AFFILIATES
SERVICES			
PAY SERVICES			
ATC PROGRAMMING			
PAY SERVICE:	HBO	+	(+)
	CINEMAX	+	(-)
BASIC SERVICE:	USA	+	(-)
	BET	+	(+)
VIACOM PROGRAMMING			
PAY SERVICE:	SHOWTIME	(-)	+
	TMC	(-)	(-)
BASIC SERVICE:	LIFETIME	-	+

NOTES AND SOURCES: Relationships in parentheses are not statistically significant at the .01 level. National Telecommunications and Information Administration (NTIA), *Video Program Distribution and Cable Television: Current Policy Issues and Recommendations* (U.S. Department of Commerce, June 1988), Chapter 6.

service and more specialized basic services (Black Entertainment Network and Lifetime [see Exhibit 4]).

From the NTIA data, TCI's strategy of exercising monopsony power is overwhelmingly apparent. TCI was less likely to carry eleven of the 15 most popular basic services analyzed by NTIA. Thus, as a dominant cable operator, TCI offers fewer programs to its subscribers, saving on the cost of programming and increasing its profits.

OVER-THE-AIR TELEVISION IS NOT AN EFFECTIVE COMPETITOR FOR CABLE

Over-the-air television has proven to be ineffective as competition for cable.33/ With its limited channel capacity, and the cable strategies of bundling network programming into larger packages, there is simply no way that over-the-air television can be seen as delivering a near enough substitute to effectively check cable's market power.

Over-the-air stations are caught between a rock and a hard place. With limited channel capacity, they cannot compete with the specialized and diverse programming cable can offer. Yet as cable becomes more pervasive, the over-the air networks need to be part of the basic package to preserve their audience.34/ However, once they are on the cable, they are at the mercy of the operators for channel location. They can be easily disadvantaged by bad location.35/ Local stations can be put out of business by

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33/ Chan-Olmsted and Litman, op. cit.; and Ordover and Braunstein, op. cit., p. 561; "Testimony of William B. Finneran, Chairman New York State Commission on Cable Television," in Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988.

34/ Chapman, op. cit.

35/ See Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, pp. 657-658.

EXHIBIT 4:

PERCENTAGE OF OPERATORS CARRYING PARENT AND RIVAL PROGRAMMING

		AFFILIATES PROBABILITY OF CARRYING PROGRAMMING	
		ATC AFFILIATES	VIACOM AFFILIATES
SERVICES			
PAY SERVICES			
ATC PROGRAMMING			
PAY SERVICE:	HBO	100	89
	CINEMAX	89	47
BASIC SERVICE:	USA	97	58
	BET	20	21
VIACOM PROGRAMMING			
PAY SERVICE:	SHOWTIME	46	100
	TMC	16	21
BASIC SERVICE:	LIFETIME	82	78

SOURCE: National Telecommunications and Information Administration (NTIA), *Video Program Distribution and Cable Television: Current Policy Issues and Recommendations* (U.S. Department of Commerce, June 1988), Chapter 6.

a refusal to carry, an issue which is currently hotly debated.36/

Recent survey evidence demonstrates the problem the networks face (see Exhibit 5). Consumers increasingly value the unique aspects of cable programming that cannot be duplicated over-the-air. Consumers overwhelmingly favor a broad array of viewing choices and consider cable better than over-the-air broadcasting for entertainment, sports, cultural programs, educational programs and overall variety. With cable systems carrying the networks plus a highly valued variety of additional, popular programming in their basic tier, it is obvious that over the air cannot effectively compete with cable.

DEMAND ALONE CANNOT EFFECTIVELY RESTRAIN THE CABLE INDUSTRY'S ABUSE OF CONSUMERS

The only disciplining force left in the cable industry is consumer (un)willingness to pay, since supply-side market forces are weak at best. We cannot imagine that Congress would have deregulated the industry if it had been told that the only thing restraining cable prices was going to be the limits of consumer tolerance for price increases without viable economic alternatives. Nor would antitrust authorities ever accept an antitrust defense that said, "there is no competition on the supply side, but we are only charging the limit price on the demand side."37/ Unfortunately, that is essentially what the consumer faces today.

The fact that cable may be somewhat competitive with video rentals and the movies does not alter this basic conclusion. These alternatives are only partial competitors for cable and they are not very economic competitors. The transaction costs of

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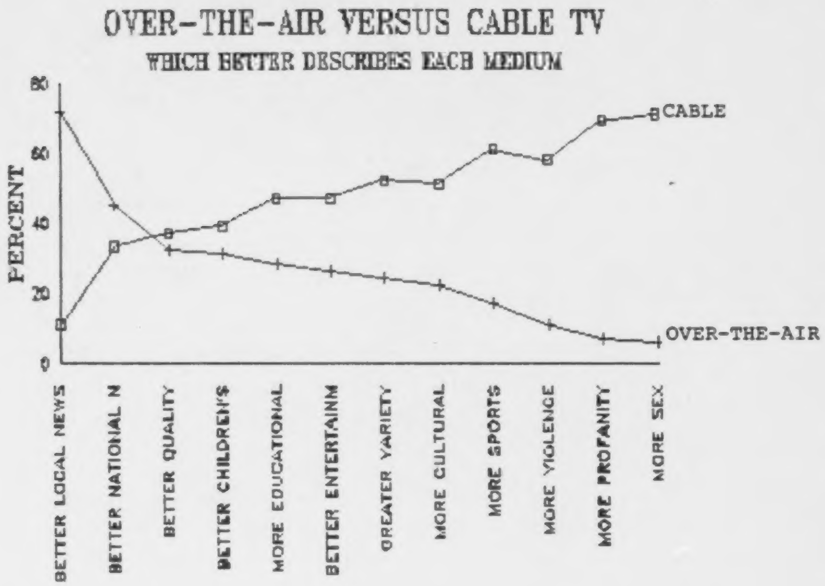
36/ Chapman, op. cit.

37/ For a discussion of the strategy and effects of limit pricing see F. M. Sherer, Industrial Market Structure and Economic Performance (Chicago: Rand McNally, 1980), pp. 232-258.

EXHIBIT 5:



SOURCE: The Roper Organization, *America's Watching The 1989 TIO/Roper Report* (1989), p. 4.

both are much higher.

Therefore, demand-side only competition would leave cable with huge economic rents resulting from its inherent advantage as a distribution medium. These rents would be competed away in a market where head-to-head competition or competition from close substitutes were present. In short, it is supply-side competition that is the key to price discipline in the cable industry and the and the absence of such competition which has allowed the price/cost ratio of monopolistic cable systems to have been driven beyond reasonable levels.

It is important to recognize as well that television viewing habits have been established as a result of 40 years of free, over-the-air television. Basic consumption patterns of information, news, sports, entertainment and culture have been deeply affected by this experience.

Americans watch a significant amount of television, 7 to 9 hours per day.38/ In the past four decades, television has taken the premier role in American life as a source of information and entertainment.

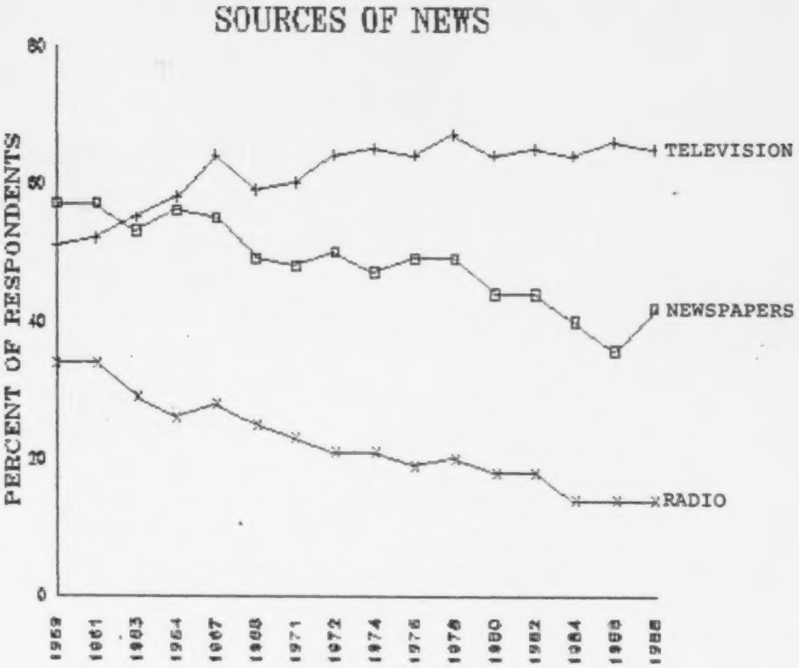
From its infancy after World War II, television grew to represent about 19 percent of every dollar spent by Americans on leisure and entertainment in 1960 and over thirty percent in 1983 (see Exhibit 6).39/ Similarly, by 1960, television was a close second to newspapers as a source of news (51 percent compared to 47 percent) followed by radio (34 percent [see Exhibit 7])40/ By 1988, television (65 percent) had far surpassed newspapers (42 percent) and radio (14 percent).

38/ Consumer Reports, op. cit.

39/ Harold. L. Vogel, Entertainment Industry Economics: A Guide for Financial Analysis (Cambridge: Cambridge University Press, 1986 p. 11.

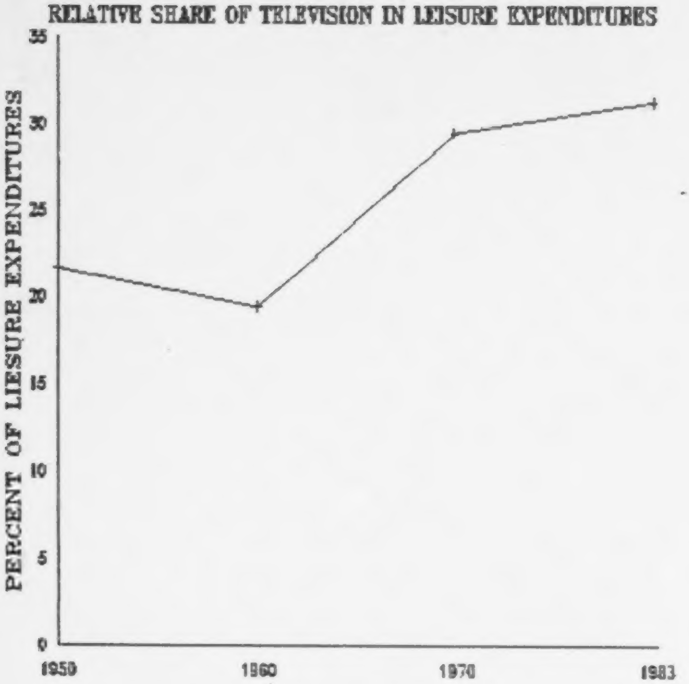
40/ The Roper Center, op. cit., p. 27.

EXHIBIT 6:



SOURCE: The Roper Organization, America's Watching The 1989 TIO/Roper Report (1989), p. 27.

EXHIBIT 7:



SOURCES: Harold. L. Vogel, Entertainment Industry Economics: A Guide for Financial Analysis (Cambridge: Cambridge University Press, 1986, P. 11.

Reflecting these underlying consumption patterns, the elasticity of demand for cable viewing is not great. Studies from the early and mid 1970s estimated the elasticity of demand at around 1.41/ By comparative standards this is quite low.42/ As penetration rates have increased and program offerings have expanded, the elasticity has probably declined.43/

While there might be some truth to the argument that the public would be better off if it watched less television, achieving that goal by allowing cable systems to ruthlessly exploit those who cannot "kick the habit" is definitely not in the public interest.

The deeply entrenched viewing patterns and strong demand for entertainment, information, news and sports gives the cable industry a great deal of market power. Thus, the weak market disciplining forces on the supply-side are matched by equally weak market disciplining forces on the demand side.

THE CABLE INDUSTRY HAS ASSERTED ITS MARKET POWER BY OVERPRICING SERVICE TO REAP EXCESSIVE PROFITS

As market power has grown the cable companies have increased overall prices, engaged in greater price discrimination, repackaged services to attract new customers, camouflaged rate increases (i.e. capture consumer surplus) and reaped huge

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41/ S. M. Besen, et al, "Economic Policy Research on Cable Television: Assessing the Costs and Benefits of Cable Deregulation," in Paul MacAvoy (Ed.), Cable Television Deregulation (American Enterprise Institute, 1977).

42/ William M. Landes and Richard A. Posner, "Market Power in Antitrust Cases," Harvard Law Review, 94 (1981), use an elasticity of 1 as low in their hypothetical example.

43/ Three factors may contribute to the decreasing elasticity of demand over time -- the habit of consumption, more programming and greater disposable income monopoly profits. Between 1984 and 1986 basic rates increased 21 percent, while pay rates increased only 5 percent (see Exhibit 8).44/ Since deregulation of rates, basic rates have increased another 36 percent, while pay rates have declined slightly.45/

In spite of rising basic rates, subscriptions to basic services increased more rapidly than pay services, in large measure because tiers were reconfigured. Operators needed to make the basic tier more attractive -- adding popular entertainment and sports programming -- to justify substantial rate increases (see Exhibit 9).

It is clear that the pricing/packaging strategy is one intended to transform consumer surplus into producer surplus. Although consumers would be less willing to pay for certain elements of the larger package, they swallow the whole thing since their access to those elements they want the most is tied to those they want less.

There is a formal theory of this extraction of consumer surplus that can be found in the economic and marketing literatures. The following is a recent statement of the principle from the *Journal of Marketing*.

> Consider, for example, a case in which we have two products or services and can estimate the distributions of *reservation prices* (the maximum amounts buyers are willing to pay) for each product. By bundling the products together, we essentially create a new product. If the two products are independent in demand, some customers who would only buy one of these products if they were priced individually will now by both products. The

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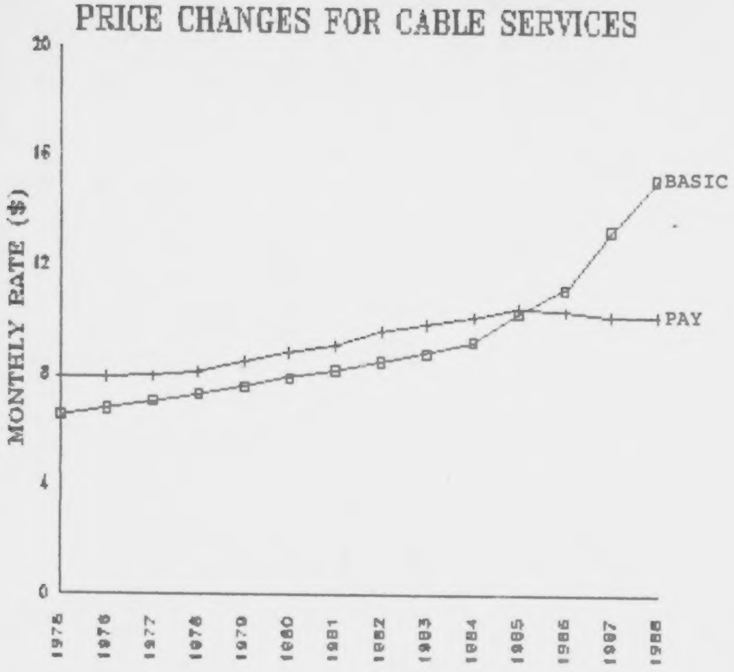
44/ Paul Kagan Associates, Inc., *The Pay TV Newsletter:Census Issue*, 1988.

45/ *Wall Street Journal*, April 7, 1989, reports the basic service increases. Kagan, op. cit., affirm the policy of maintaining pay services at stable rates.

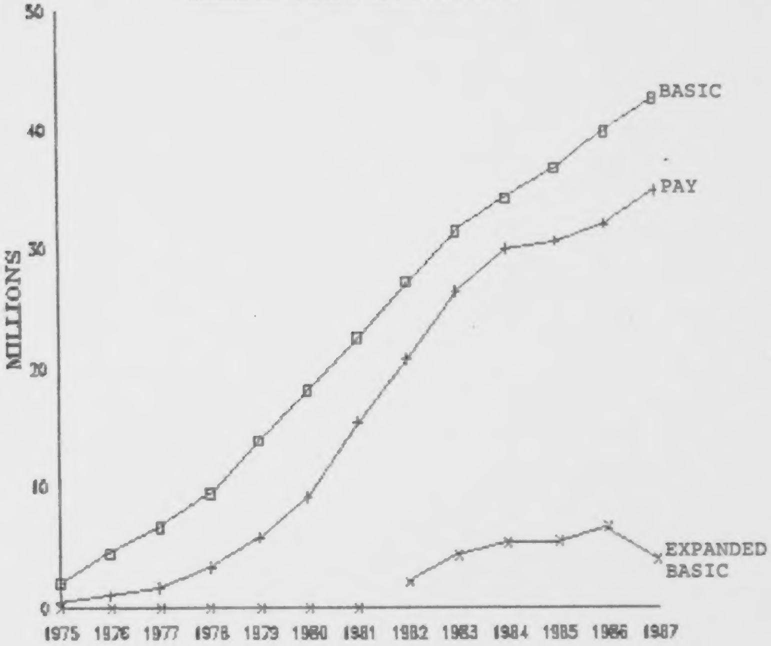
EXHIBIT 8:



NOTES AND SOURCES: Pay service rates are conservatively projected to have remained unchanged in 1988. Paul Kagan Associates, Inc., *The Pay TV Newsletter:Census Issue*, 1988. *Wall Street Journal*, April 7, 1989, reports the basic service increases.

EXHIBIT 9:

CABLE SUBSCRIPTIONS



SOURCE: Paul Kagan Associates, Inc., The Pay TV Newsletter:Census Issue, 1988.

> reason is that the value these customers place on one product is so much higher than its price that the combined value of the two products exceeds the bundled price. In economic terminology, the consumer surplus (the amount by which the individual's reservation price exceeds the actual price paid) from the highly valued product is transferred to the less valued product).46/

There is also graphic evidence of this practice in the cable industry. Pre-deregulation pricing left some consumer surplus in the consumer's pocket. But deregulated pricing strategies have moved aggressively to bundle services and capture consumer surplus.

> If viewers can purchase one channel and watch a second channel for free, they never will pay the market value of the second channel. A more profitable alternative for the pay television operator would be to offer program type A on the first channel and program type B on the second, and then sell both channels as a package. At an appropriate price, consumers will purchase the package. Even if the costs of scrambling were minimal, the package selling strategy would be more profitable than selling each channel individually.
>
> The practice of bundling recognizes that consumers have preferences not only for program types, but also for program variety. For example, some consumers might pay $25 for service A only; $25 for service B only; but $37.50 for a bundle of both A and B. Bundling is like an insurance policy. Whatever occurs, the consumer can watch his or her preferred program.
>
> But package selling may be attractive even aside from its insurance policy attributes. With package selling, the profitability of carrying a program type depends not only on how much revenue it generates on its own, but also how much it

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46/ Joseph P. Guiltinan, "The Price Bundling of Services: A Normative Framework," Journal of Marketing, 51: April (1987), p. 75.

increases the total package's revenues.47/

The margin is higher on basic than on pay, yet it is basic that is being increased and will continue to be. It is acknowledged that in the deregulated era the rebundling of services is constrained only by efforts to keep the price/value ratio below the drop-off point.

> If we go out and sell the value of the product, then we can all stop worrying about pricing... operators concentrate on persuading consumers that cable is more valuable than the rates being charged.48/

This pricing strategy of extracting surplus by bundling premium services with basic is consistent with evidence on consumer preferences and the cable industry's advantages over its competitors. The result is excess profits.

It is difficult to obtain direct data on the profitability of cable operators or programmers because they are frequently subsidiaries of holding companies. However, an analysis of purchase prices for cable systems indicates very large monopoly profits inherent in the industry.49/ Although there is quibbling over methodology, cable systems are clearly selling at several times their reproduction costs.50/ That is, if barriers to entry could be removed and fair access to programming could be ensured competitors could enter and build systems at less than half of what existing systems are selling for.

47/ Cecilia Conrad, "Choosing Cable Programming Services," Cable TV and New Media, 4:9 (1986).

48/ "How to Raise Rates and Survive," Broadcasting, NCTA, 1987.

49/ Shooshan & Jackson Inc., Measuring Cable Market Power: Recent Developments (Washington, D.C., December 1988), summarizes the development of this argument.

50/ Robert M. Pepper, Through the Looking Glass: Integrated Broadband Networks, Regulatory Policies and Institutional Change (Office of Plans and Policy, Federal Communications Commission, November 1988).

The growth in these monopoly profits since deregulation is also clear (see Exhibit 10). In 1983 reproduction costs were estimated to be approximately $600 per subscriber. Sales prices on cable systems were in the range of $900 to $1200. Estimates of today's reproduction costs are in the range of $600 to $1000. Sales prices of cable systems have jumped into the range of $2200 to $3000.

The estimate of reproduction costs of around $600 for both 1983 and early 1989 may seem inconsistent, but they are not. Interest rates are a key component of the cost of capital for intensive projects like cable systems. A decline of about three percent in the cost of borrowing since 1983 would offset the general increase in the cost of building systems.51/

The estimates of sales price compared to reproduction costs suggest that competitive entry would drive rates down dramatically. The monthly cash flow necessary to earn a reasonable profit on such competitive systems would be less than half of what is currently being paid. Savings to consumers would be on the order of $6 billion.

CONCLUSION

CFA believes that Congress must step in to bring cable rates back into line with costs and promote greater competition in the cable industry. Without public limitations on cable rates (i.e. a new definition of effective competition that suits the monopolistic market conditions) and anti-discrimination/common carrier rules for cable operators, diversity of programming will

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51/ Compare the producer price index and the yield on long-terms corporate bonds, Economic Report of the President, February 1989.

EXHIBIT 10:

ESTIMATES OF REPRODUCTION COSTS AND SALES PRICES OF CABLE SYSTEMS

YEAR	REPRODUCTION	SALES PRICE	RATIO OF AVERAGE SALES PRICE TO REPRODUCTION COSTS
1983 (a)	$645	$695-1110	1.5
1986 (b)	$616-1000	$1650-1732	2.1
1988	$600-1000 (c)	$2300-3300 (d)	3.5

SOURCES:

a/ Harold. L. Vogel, Entertainment Industry Economics: A Guide for Financial Analysis (Cambridge: Cambridge University Press, 1986, Chapter 7.

b/ Shooshan & Jackson Inc., Measuring Cable Market Power: Recent Developments (Washington, D.C., December 1988), summarizes the development of this argument.

c/ Low estimate is (b) above, high estimate is Robert M. Pepper, Through the Looking Glass: Integrated Broadband Networks, Regulatory Policies and Institutional Change (Office of Plans and Policy, Federal Communications Commission, November 1988).

d/ See (b) above.

be curtailed and consumers will continue to be overcharged for cable services.52/

52/ This solution stresses regulatory intervention to foster competition and restrain rates and does not contemplate lifting the ban on telephone company ownership of cable systems. Telephone company entry into cable would not be pro-competitive at the present time. Unless and until local telephone companies can be prevented from overpricing monopoly basic telephone service to subsidize competitive ventures, consumers stand to lose more than they would gain from telephone company provision of video services (see Comments of the Consumer Federation of America, *In the Matter of Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54 - 63.58*, CC Docket No. 87-266, December 16, 1988). The inevitable remonopolization of video services by an even more potent monopolist, who integrates both telephone and video services, poses an even greater threat to the public interest than the current state of affairs. In the long-term, the need for procompetitive open access rules and restraints on rates would be even greater with a telephone company-based monopoly of video home entertainment services, while, in the short-term, the monumental burden of preventing cross subsidy would be added to a regulatory apparatus that has proven ill-equipped to handle the task.

Senator **Inouye**. Thank you very much. I have just one question, a question that I believe I should have asked Mr. Mooney, and if he wishes to he can elaborate on this and maybe you can provide the answer.

During the past four years, a time of a very high level of national economic activity, thousands of business enterprises have gone bankrupt or taken advantage of Chapter 11 provisions, including independent TV stations and hotels and shipping companies and grocery stores.

Are you aware of any cable operator or cable system who has gone bankrupt in the past four years, Mr. Schmidt?

Mr. **Schmidt**. I need to respond in two ways to your question, Mr. Chairman. I think the answer is no, they have not gone bankrupt.

Secondly, I have to tell you a story that relates to a programming service, because what has happened when ideas came forward for segmenting the marketplace, for example, the home shopping market, some of the operators felt it was good for them to share in this new revenue stream and so some of them chose to start their own service. This is reported in the trade magazines so this is not any confidential information.

Cox Broadcasting had a local shopping channel in San Diego. It went bankrupt. They did not take the bankruptcy road. What they chose to do is use their leverage to have an auction and they contacted all the other home shopping services and said look, someone is going to bail us out of this problem. Whoever bails us out will get position on our system. So in effect they auctioned off their channel on their cable systems.

The only reason I know this with some interest is that my mother, who is 80 years old, was watching a shopping service in Bakersfield, California that suddenly was taken off the air—a fabulous shopping service. The reason was, they lost out on the auction so the other company got the channel as part of the San Diego bailout but the Cox System consumers are the real losers.

So there have not been any bankruptcies. What they have done is, they have been able to use the leverage again of the channels to avoid any financial loss on that side.

Programmers have taken some hits. There have been some programming services who have come to the marketplace that have not succeeded. But a good example was that most of those predate 1984.

Everybody who has come since 1984 has had to follow the movie, the Godfather. You go and see the major cable operator first, or operators, and you say, we would like to get into this business, and then the other party says, well we are your new partner, but we have a carried interest. We do not put up financial risk. We put up our channels. That is our financial risk.

Many cable operators today talk in terms of their channels as being worth in excess of $1 million per channel as a capital contribution to an enterprise. So that leverage is evident in many different ways but the bottom line is, I do not believe any cable operators have taken any financial bankruptcies.

Mr. **Padden**. I am certainly not aware of any.

Senator **Inouye**. Senator Gore?

Senator **Gore**. There have been a lot of bankruptcies of satellite dish distributors, have there not, Mr. Phillips?

Mr. **Phillips**. Yes, sir.

Senator **Gore**. Mr. Chairman, you said, I am told—and I had to go to that ICBM modernization hearing—that while you do not favor precipitous action, that deliberate action, if and when taken, will be based on the record compiled here today.

I think that the testimony of this panel, taken together, is a compelling record, and I think the statements taken together really are devastating in the critique they present of the results of the 1984 Cable Act.

Which of the witnesses was talking about equity ownership required for new cable distribution, or new cable programming? Was that you, Mr. Padden?

Mr. **Padden**. Yes. I mentioned that in my remarks.

Senator **Gore**. Could you very briefly tell me what you meant by that?

Mr. **Padden**. I was responding to the Klein study that the cable industry has proffered, purporting to show that vertical integration is not a problem, and if you isolate out in their analysis the newer services, you will find that the only newer services that have succeeded are the ones that have operator equity, and I would like to just give one example, if I can.

A couple of years ago NBC decided they wanted to enter the cable news business and offer consumers a choice of cable news services. They said they would not do so unless they got a certain threshold number of commitment from the cable industry to carry the service.

It came down in the end to whether TCI was going to decide to carry it or not carry it. NBC went to see TCI and Ted Turner went to see TCI to say oh, please do not do that, and in the end TCI decided the answer would be no, and when the dust settled TCI owned 5 percent of Turner Broadcasting Company and it is not clear to me whether that was a coincidence or somehow related to the transaction.

Then a couple of years later NBC—God love them, they are trying—they said, we are going to try again and we are going to come in with consumer and business news. The first thing they did was make a deal with TCI to buy something called Tempo Television, that as near as I could tell had no assets at all, for $20 million. That payment has all the appearances of the payment of tribute to a monopolist for access through his toll gate.

Senator GORE. It was a shakedown?

Mr. PADDEN. Sure. Then, in the affiliation agreement——

Senator GORE. I mean, that is—you know, the word is humorous in this context, but that is really exactly what it was.

Mr. PADDEN. That is exactly right, and it gets even worse, because in the affiliation agreements that they signed with many MSOs who own a piece of CNN, in order to get on their systems they had to promise in writing not to expand the consumer and business news service into a general news service that would compete with CNN, and I would challenge any of the cable witnesses you have had to come up with any pro-consumer, pro-competitive reason why NBC should be required to promise not to provide the American people with a competitive source of news.

Senator GORE. Well again, there is the ownership—the equity participation by the cable industry, correct? So they do not want the competition for that service. It is not complicated.

Are any of the witnesses familiar with why the Reverend Pat Robertson decided to scramble the Christian Broadcasting Network?

[No response.]

Senator GORE. Well, we had—I mean, in fact, Reverend Robertson would seem to have, at least a couple of years ago, have had several reasons to want more viewers. He was preaching the gospel, he was running for President, and he was raising money hand over fist, and he would seem to have every incentive to want as many people watching his service as possible.

Well, when he provided it in an unscrambled form to satellite dish owners he was intimidated. He was threatened by the large multi-system cable operators and told, point blank, if you do not scramble we will take you off our large cable systems in the cities, and since most of his viewers were still in the cities, he yielded to the intimidation.

He was shaken down, in effect. It is the same routine all over again.

Now, when somebody wants to distribute the signal and is not in the brotherhood—is not in the cable Cosa Nostra, the family that controls the distribution, then what happens? There is only one.

The political pressure to release the grip just enough got to the point where the national rural co-ops got involved. Big fanfare. Boy, this is great. It is a breakthrough. At least rural Americans who do not have any cable service are going to have some way to get this distribution.

In good faith the rural co-ops got together and formed this new entity. How long, Mr. Phillips, did it take you to negotiate the contracts with the programmers?

Mr. PHILLIPS. Senator, I think it has been roughly three years that we have worked to get to where we are today.

Senator GORE. Three years, and you testified earlier that the rate you pay is 440 percent more than the rate paid by a cable system of equivalent size.

Mr. PHILLIPS. That is correct. Some of our members operate small cable systems in rural areas. We compared their rural cable system rates to the rates that NRTC receives at wholesale to distribute to the dish market. The range is a low of 167 percent to a high of the 780 percent. The average is 444 percent.

Senator GORE. That is another shakedown. It is another shakedown. How many subscribers do you have?

Mr. PHILLIPS. 30,000.

Senator GORE. 30,000. What is your potential subscriber base?

Mr. PHILLIPS. The electric cooperatives and the telephone system serve 14 million homes.

Senator GORE. Okay. Now, out of 14 million potential subscribers, you are only able to serve 30,000. The satellite dish dealers are going bankrupt right and left. The sales are down.

All because the cable industry has been given by the Congress of the United States so much power that they are able to squeeze to death any vestige of competition.

Now they come before here and they say, oh, you forget about Nintendo. We compete with Nintendo. We compete with video tape rentals. We compete with the radio. We compete with CBs. I mean, it is ridiculous.

Effectively, within the relevant market, they have neither competition nor regulation. If NRTC were able to receive distribution, terms and rates comparable to cable, how quickly do you think NRTC might be able to provide service to those families that cable has chosen not to serve?

Mr. PHILLIPS. Senator, that is our real goal. We would like to be able to provide TV as a universal service, just like we have telephone and electric service.

The problem we have had is that the customer in the rural area has to buy their satellite dish. We have tried to assist in that by helping with financing and favorable terms.

But even then if you take a $2,000 investment and you spread it over five years and you give it a very favorable interest rate, you still have a cost of some $40, $45, $50 per month for the dish and then you add the cost of the programming to that.

So what we are trying to do is reduce the total cost of distributing the product to the consumer. It should be at least comparable to cable-delivered television. That is the goal.

Senator GORE. Well, the forces of competition would naturally force the price, the wholesale price, down. I mean, the supply and demand curve would cross at a different place where the consumer is absorbing the capital cost of the distribution system.

Mr. PHILLIPS. That is correct.

Senator GORE. Yet they require 440 percent higher rates, just because they have the power and the arrogance that goes with it. I mean, it is just not complicated.

Now, you have this satellite distribution wavelength, the KU band, and they are aggressively moving to extend their monopoly power by buying up the band width in KU band, correct?

Mr. Phillips. Yes, sir. That is our fear.

Senator Gore. This is just an outrage. It is just such a clear case. Go ahead.

Mr. Phillips. The opportunity the K band presents is significant, because you can bring the cost of the equipment down. In Japan and in Europe they are launching K band services where the cost of the equipment is in the $400 to $500 range, so we would be in the position to bring low-cost equipment to rural America that could receive the signal.

The problem is the massive amount of capital it takes to launch the service, plus getting access to the programming.

Senator Gore. They want to buy it up before it can pose any threat to them. It is a classic case of a technology feeling the onset of competition from a more efficient technology, or a technology that is more efficient in some ways, and then trying to use its existing market power to stifle the competition before it gets off the ground.

Mr. Padden—I will come to you in just a moment if I have time, Mr. Schmidt. I definitely do want to hear from you.

Mr. Padden, Mr. Mooney defended cable's incessant drive toward vertical integration of the program supply and delivery system. Recently, Tony Cox, the President of Showtime, said that the Super Bowl is going to be on pay-per-view cable, and I think it is important to note that prediction—that it would move not only to cable but pay-per-view cable.

I understand also that there are plans to place a large part of the 1992 Olympics on cable. Southeastern Conference football I am given to understand will be withdrawn from free TV this fall and made available only on pay cable, and baseball is rapidly moving toward cable only broadcasts.

If the monopoly power is left as it is, do you see this as the trend to the future?

Mr. Padden. I do not think there is any question about it. We are very concerned about it. As you know, I make no bones about it, we have a vested commercial interest in this. We make money providing free, over-the-air telecast of sporting events in our community. That is one of the ways we compete with the network stations.

But—and I have to say if the cable industry takes new sporting events or other events that we have not been giving to the American people for free and put them on a pay channel and charge people, that is a net plus for diversity and even though people have to pay to see it, they are getting something they were not getting before.

But when they take the very games—and this is exactly what is happening right now—the very games that we have been providing free of charge—we have commercials in it, they put commercials in them too, so there is no net benefit there. The only difference is, the public has to pay for what they used to get for free.

We cannot see any net benefit for consumer welfare in that and it is happening and I would associate myself with Mr. Kimmelman's remarks about the issue of prematurity. The Cable Act was passed in 1984. This is happening right now. It is not premature for Congress to do something about it.

Senator GORE. Mr. Schmidt, you wanted to comment?

Mr. SCHMIDT. In all due respect, Senator, to your personal outrage—and I share your outrage—I do not think the issue is personalities. I think it is an institutional issue now.

Senator GORE. I agree totally.

Mr. SCHMIDT. I think the problem has reached a level where the thinking that is going on today, specifically related to sports—and maybe there can be another day to focus in on sports as an issue. I represented 19 of the NBA, NHL and major league teams in negotiations with cable several years, most recently in 1986. There are issues that I think have to be dealt with, and the public's benefit is not necessarily the key issue today.

But the bottom line is, I really believe, there is developing a have/have not equation between rural America and urban centers. And whether it is backyard dishes, or wireless cable, or whomever, there should be a choice.

Senator Pressler's constituents, who are some of our members, deliver in South Dakota 18 channels up to 40 miles from the transmitter to people who otherwise would have nothing, in a different set of economics. They pay us a regular fee just like a cable subscriber. But the bottom line is they still are deprived of programming.

People watch programming. They do not watch technology. The consumer does not want to have you say to them I am sorry, I cannot sell you HBO. I am sorry, I cannot give you the sports you want. That is where the problem lies, and that is where the leverage is, and that is what cable has effectively done and continues to do to try to wrap up all that product.

Senator GORE. And it is worth underscoring the fact that since the 1984 act, only six, I am told by staff, only six new premium programmers, only six new basic programmers have broken into the marketplace in a significant way, and all six of them are at least partially owned by the cable industry.

Mr. SCHMIDT. It is a given.

Senator GORE. It is a given. Would you predict for us that from now on you are not going to see any new programming break into that top 10 list unless the cable industry owns it and controls it?

Mr. SCHMIDT. Not only will I predict that, but I think one of the very revealing comments that was made at the national cable show this year was a mind-set that was being developed to say fewer is better, where they are saying we are going to have fewer channels, and therefore, the value of the channel is going to increase.

Senator GORE. Are you starting to get some indications of the cable systems charging for the placement on the spectrum, to get a low channel placement?

Mr. SCHMIDT. I think it is all in the cards right there in front of us.

Senator GORE. Is that already going on?

Mr. PADDEN. It is happening now, and a number of the basic cable services offer a discount in the charge that they impose on the cable operator for carriage of their service, if the cable operator will put them down on channels 2 through 13.

Senator **Gore**. And some of the network signals, the over-the-air broadcasts, which have long been associated with channel 4, or channel 9, or channel 7, on the cable system, suddenly find themselves put into Siberia on channel 51, because they have not paid the money to maintain their position in the lineup. It is a shakedown.

Mr. **Padden**. It is even worse than that. As I indicated up there, the first problem under cable is legal environment. They get the free use of our service, so we cannot discount the charge we impose on the cable guy because Congress has prohibited us from imposing any charge, has given the cable industry carte blanche: you take all the broadcast programming and use it for free.

And going back to the sports for a second, attachment number four to my testimony is an ad that appeared in a suburban New Jersey newspaper. You talk about arrogance. It is a picture of a table radio, and the headline says, "If you do not have cable, enjoy watching the Mets game tonight." I mean, it is derisively ridiculing people.

Senator **Gore**. Just rubbing it in the consumer's face. Well, that is the point we have gotten to.

Mr. **Padden**. Let me add one thing. It is not our position that the cable industry is populated by evil people, and the fault is not theirs. They are no more guilty than a child let loose in a candy store. And with all due respect, I really think it is the Congress that has to take responsibility for the situation we have and move to correct it.

Senator **Gore**. Well, let me conclude because my time has long since has expired, and I appreciate the Chairman's courtesy. I could not agree more with your comments, Mr. Padden, and yours, Mr. Schmidt, that it is not a question of personalities, and it is not a question of the individuals in the business. And there are a lot of great people in the cable business.

But as I said in my opening comments, the structure of the industry, this industry that has been given a free shot at the consumer, with no competition, and no regulation, and no inhibitions on anti-competitive behavior, this situation is encouraging the worst instincts to come out. And it is predictable, and the fast buck operators are lured into this kind of situation because they see an opportunity to make a killing at the expense of the consumers and at the expense of would-be competitors.

And I agree with your last comment, Mr. Padden, that it is the Congress that will be to blame if Americans wake up next year and find the Super Bowl on pay per view cable, college football, et cetera, and all of these other would-be competitors going bankrupt. And we can say well, we did not know, we did not know. Well, we do know, because this panel has told us very clearly exactly what the problems are, and our constituents are telling us.

And I just appreciate the Chairman having this hearing, and I hope that one result will be to build support for measures to change this situation.

Thank you, Mr. Chairman, for your indulgence.

Senator **Inouye**. Watch your blood pressure.

Senator GORE. This hearing has been a real tonic.

Senator INOUYE. Now we will hear from our man from Montana, who feels that his constituents have been culturally deprived because no one goes out there.

Senator BURNS. Since we have only got 15 minutes until lunch, and obviously, I have never missed a meal I will keep my comments brief.

I guess we are looking for solutions, and as I hear this whole thing unfold, it sounds like we have got a little good, old American greed going on here. And I guess what we have to do—and competition is what drives this country, and it seems like that I always get nervous when there is somebody that stands at the tap that has the ability to turn the tap, even in programming.

I guess what we are looking for are solutions here. And, Mr. Phillips, I guess I am probably as close to your industry in Montana than probably the rest of you. Free television, I come out of the broadcast industry. In fact, I operated a regional radio network, and I did not sell any part of my network to get on that radio station, thank goodness. And it was kind of a different situation anyway.

I want to ask, I guess, Mr. Phillips, or any of you could address this question. What would happen—and we are looking for solutions here—what would happen if the telephone industry, through the laying of fiber—and we know it is coming. We know it is coming. In other words, when you get the telephone in your house, they are going to be able to bring you a host of services, if they are allowed to do that by regulation to allow telephone entry into the cable industry, and then some way couple that with, combined with, say, a published rate for programming, and with the right of no refusal. In other words, if I called up HBO and I said I have got so many subscribers, I can substantiate that, and I am going to pay you; and he cannot refuse it.

Would that take care of the problem, or does that open up another whole box? And I would just ask for a response, because I am looking for how this can be resolved fairly and with everybody reading from the same rule book and playing on the same football field; and it has got to be level.

Mr. SHOOSHAN. Senator, maybe I could lead off. Certainly, I know what the position of the U.S. Telephone Association. USTA does not necessarily envision the telephone company as the pervasive provider of video services to the home. I think the fact of the matter is that what USTA seeks and what I think is the practical and the best alternative for consumers is a multiplicity of different ways of getting video service to the home, whether it is wireless cable where that makes sense, or the dish industry where that makes sense.

So I think those that present to this committee the idea that what the telephone industry is seeking is a monolithic opportunity to stand astride all television programming are misleading the committee. What telephone companies want, from the largest Bell companies to the smallest, rural independents, is the opportunity to make a decision about whether it makes sense to get out there and provide the service that you are so interested in getting.

And I think that what the telephone industry is looking for is the ability to be a gateway; that is, someone who will be there to provide to the rural consumers or the urban consumers all kinds of program services, not the gatekeeper that the cable industry is today. And all the industry says is once that gateway is in place, what is wrong with the telephone company or a program service that they would have an interest in being one of the many voices that is provided over that gateway? I think that is a big difference from the current market structure in cable where there is one voice that determines what programming services you get in that market.

What the telephone industry is looking for is a gateway which will permit Mr. Padden and Mr. Johnson from Black Entertainment Television to both have an opportunity to get on that system. That is a far different environment than we have today. And so I think it would go a long way to addressing your concerns, but it will not supplant, nor is it intended to, the opportunity for satellite earth stations, or MMDS where those are the more efficient technologies, to get out there and compete as well.

Mr. PHILLIPS. I would like to also add, Senator, there is something that you should consider in that regard. About 100 of our members are telephone systems as well, and they are involved in the distribution business because the fiber optic technology for rural America is not mature.

Senator BURNS. And it is not going to come right away because it is very expensive, and it is going to come very slowly.

Mr. PHILLIPS. That is correct. So the suggestion you pose may not be an immediate solution. Over the long term, fiber may very well serve all the rural homes, but in the interim there is the satellite dish technology. And the next technology is KU band, which I mentioned has the potential to bring the cost of the hardware down dramatically.

And that is why we are so alarmed about these recent moves by cable MSOs to lock up all of that capacity that is available today. That is something we think you should look at as well, if you are looking for an answer in rural America.

Senator BURNS. Well, we have—and I would just make a comment here—we have a problem as far as in the livestock business—and I am more familiar with that—as the Packers and Stockyards Act strictly prohibits packers from owning feedlots. They cannot—we are worried about the same thing, that packers will be coming out, and they will be contracting calves before they are even born, and they go to a specific feedlot and on into their packing plants. And the concentration, it eliminates the competition on who is going to buy your livestock, the final user.

And I am wondering, you know, somewhere along this line that—I am just looking for a way that allows every segment of this industry to compete. In other words, if I have a radio program and I have to compete against another farm broadcaster for my service, then allow me to compete. But I am just looking for a way.

Mr. SCHMIDT. If I could give you just a brief response. First of all, Senator, I think there is precedent. When CBS was in the cable business, they owned Viacom, and they were forced to divest their cable interest because of the issue of the closed link here that you are talking about in the analogy to your livestock story. That might be another solution, if this Congress saw sufficient abuse, to divest their interest in programming and be in the distribution business only.

Now, that would cause a tremendous amount of anxiety, I want you to know, on their side of the fence. And frankly, the issue of Telco in cable is an issue that probably should be explored on another day as well, and that is economics.

And I think John Malone of TCI tried to give you a brief lesson in economics here about how poor cable was; it has not made a profit. Well, I remember when we used to go around and try to get bankers interested in the cable business in the early 1970s. They said it is not a business. There is no return on investment, no ROI. And the bottom line was because it was a different kind of business, it was a cash flow business. And the cash flow that this industry generates is phenomenal. That is what has allowed it to generate and build these systems.

Well, the telephone industry has a different set of economics. They have got a ceiling there in their own rate structure as a regulated industry, so they have got a different set of economics; and so I do not think they are going to come and take the risk.

So, again, I have no problem with whoever wants to compete, but I am back to the now premise, will the consumer today—you see, we have come so fast. Cable has provided so much, in all due respect; they have provided a phenomenal service. But someone said it earlier, it is moving now to become more than just a casual entertainment issue. People feel it as something that is taking on almost a degree of necessity. And those people who do not have it are deprived, and they should not be deprived.

It is not a technology issue. There is technology available. And if the telephone industry wants to come, they can come, properly protected and so forth. That is where the consumers will win.

Senator **Burns**. Well, I would just make the point here that free broadcast has served this country very well, but when we say free broadcast, it was not free. Now, we get to talking about these things, and everybody leaves out the possibility. Advertisers pay the freight.

Now, I have a problem—and I stated this in the last hearing—I have a problem paying a quarter for a newspaper to read their ads, and I know they are going to be 60 percent ads, because if they are below 60 percent, they ain't making no money. I have a problem with that.

I also have a problem with turning on and paying $15 or $20 to watch somebody else's advertising when the freight has already been paid, so to speak. Okay. I have a problem with that.

I am just looking at this rural thing here, and the rates, 35 channels cost the rural people $29. Now, this is irrespective of the equipment; I am not going to talk about equipment. It costs them $29 in the rural areas, $14 in town.

Mr. **Phillips**. Yes, sir. That is correct.

Senator **Burns**. And I think there is a disparity there. And really, I feel sorry for—my heart is with agriculture, and because I know we sell wholesale and buy retail and pay the freight both ways and, by gosh, that gets a little bit tough.

And so I am just looking for suggestions and solutions on how this—and still allow this entrepreneurialship of the programming and not limit that. I want these people to be in business, and I want them to make money, because I believe that that is what drives this country is the ability to make money. But I want all segments of it to make money, too, and be able to compete.

Mr. **PADDEN**. Senator, if I could respond to your comment about the telephone company for a moment. I think your feedlot analogy is right on. And if we have learned anything from the cable experience it is the danger of mixing conduit and content.

And we would strongly urge that in any consideration of telephone company entry into this market, we not duplicate the tragic error we made with cable, and we make sure that there is no vertical integration by the telephone company into television programming content. I think they can make a nice fortune being a disinterested conduit, and that is the most we ought to be contemplating.

Senator **BURNS**. I have no other questions, just a comment. It might be like a packing house. There might be a little blood on the floor before this is all over. We might as well just put sawdust on the floor right now.

Thank you, Mr. Chairman. I appreciate the opportunity.

Senator **INOUYE**. Thank you.

I gather that Senator Gore has a little more adrenalin to expend.

Senator **GORE**. Mr. Shooshan, am I correct in understanding that there are already several hundred telephone companies across the country that are now offering cable services?

Mr. **SHOOSHAN**. I think that number is close to correct. They are offering cable service in rural areas where they have been able to take advantage of the exemption that was in the FCC rules and that Congress wrote in in 1984.

Senator **GORE**. What has been the experience of state regulators and these telephone companies in preventing cross-subsidy?

Mr. **SHOOSHAN**. Well, again, I cannot speak to each specific case, but my general impression is that those telephone companies which have been permitted to provide cable in rural areas have done so without allegations of cross-subsidy.

And, Senator Gore, if I could add to that, there is—I mean, I would obviously disagree with my good friend, Mr. Kimmelman, about the ability of regulators to police against cross-subsidies. But I think there is another example of where it is clear that the regulatory process is working.

Mr. Mooney mentioned earlier that C&P Telephone here in Washington is the contractor which is building the cable system for Bob Johnson for DCI. It is doing so after passing approval by both the FCC and the D.C. Public Service Commission. There have been no allegations that telephone company provisions of those facilities to the cable operator is leading to unwarranted cross-subsidies.

I think that when you hear the cable industry raise this concern about cross-subsidies what they are really concerned about is competition. In the rural example you pointed to and also in those few urban examples where telephone companies are building the facilities without allegations of cross-subsidy, the problem of cross-subsidies that can be dealt with by the regulatory process.

Senator **Gore**. I wanted to just note one other thing, Mr. Chairman, and that is, Mr. Phillips drew an important connection between the growing problem with theft and the truly outrageous, monopolistic pricing practices that are now present in the program distribution business.

I have been one of the leaders—I have tried to be one of the leaders in anti-theft legislation. We have passed the toughest possible anti-piracy provisions, and I have legislation pending to tighten them up even more.

But I think the connection he drew is a very important one for this committee to hear and to understand, because fighting this problem may well be impossible just with penalties and enforcement, when the signals are falling on people's yards, and the electronic industry is so vital that it produces new decoding devices fairly readily.

So I think we do have to move on both fronts, even if our only concern was theft, because as long as the marketplace is so artificially constrained and structured in a way that gives these monopoly profits, then you are going to have this continuing problem. I thought that was an important point that needed to be underscored and brought out.

In closing, Mr. Chairman, I want to thank you again for having these hearings, and I really hope that we can move on some legislation in this Congress. I am interested in the Cable Competition Act that is co-sponsored by two other members of this committee, and also in legislation aimed at freeing up the satellite dish owners from this monopolistic horror, these monopolistic constraints that have produced this horror story.

In any event, I look forward to working with you, Mr. Chairman, and with our colleagues in moving this situation along. Thank you.

Senator **Inouye**. I thank you very much.

Listening to this panel, if I were a cable operator, I would say it is time for Rolaids.

I thank you all very much, gentlemen. You have been very helpful to the subcommittee. I have no idea when we will be acting upon your recommendations, but you may be assured that they did not fall on deaf ears.

We will continue our discussions tomorrow. Our hearings will commence at 9:00 tomorrow morning. And so until then we will stand in recess, with our gratitude.

[Whereupon, at 12:35 p.m., the subcommittee was recessed, to be reconvened at 9:00 a.m., the following day, Thursday, June 22, 1989.]

[The following information was subsequently received for the record:]

NATIONAL RURAL TELECOMMUNICATIONS COOPERATIVE

P.O. Box 9994
Washington, D.C. 20016

1115 30th Street, N.W.
Suite 104
Washington, D.C. 20007

(202) 944-2539

June 28, 1989

Honorable Daniel Inouye
Chairman
Subcommittee on Communications
Committee on Commerce, Science and Transportation
U.S. Senate
227 Hart Building
Washington, D.C. 20510

Dear Chairman Inouye:

I appreciated the opportunity to appear before your Subcommittee on June 21, 1989 regarding media ownership. I also am appreciative that you said that our testimony did not fall upon "deaf ears." Consumers should not be economically penalized in paying for programming delivered by satellite simply because they do not have access to hard-wire cable or because they live in rural America.

As I testified before your Subcommittee, NRTC's wholesale programming costs are 444% higher when compared to a comparable cable system's wholesale costs. In Attachment A of my June 21, 1989 testimony, I demonstrated that a satellite consumer would have to pay $29.12/month to receive equivalent basic programming available to a cable consumer for $14.60/month (figures from the National Cable Television Association).

To support this comparison, I would like to submit for the hearing record a June 21, 1989 letter from the Satellite Broadcasting and Communications Association (SBCA), the trade organization of the satellite television industry. SBCA has been summing programming prices so that satellite programming "pirates" who have been stealing signal can be assessed adequate restitution for the stolen programming signals.

In the attached letter, the SBCA states that in order to make programmers whole on subscription fees on a typical 11 signal (basic plus three premium) package, a conservative restitution estimate is $35.45.

Let me review the cost comparisons:

Distribution	# Channels	Cost	$/channel
Ave. cable delivered package	35 basic	$ 14.60/mo	$ .48/chan.
Ave. dish package - no delivery	35 basic	29.12/mo	.83/chan.
SBCA restitution - no delivery	8 basic	13.00/mo	1.60/chan.
SBCA restitution - no delivery	8 basic + 3 premium	35.45/mo	3.22/chan.

This should clearly demonstrate that the home satellite dish consumers are paying magnitudes more for programming than their cable counterparts. There is simply no justification for this price disparity except clear and demonstrated marketplace greed.

Thank you for including this the hearing record.

Sincerely,

Bob Phillips

Bob Phillips
Chief Executive Officer

Attachment: SBCA letter

cc: Subcommittee Members

Satellite Broadcasting and Communications Association
of America

Officers

President
Chuck Hewitt

Chairman
Gordon Main
Main Electronics Co

1st Vice Chairman
Robert N. Caird
Home Box Office, Inc.

2nd Vice Chairman
William E. Berman
GE American Comm., Inc.

Past Chairman
H. Taylor Howard
Chaparral Comm., Inc.

Directors

Donald Berg
Channel Master

Edward E. Reinhart
COMSAT Corporation

Mike Schroeder
Consumer Satellite Systems

Larry Dunham
General Instrument Corp.

Tom Ortolf
HTS

Dan Zinn
Hughes Comm., Inc.

Brian McCauley
Netlink

G. Todd Hardy
PRIMETIME 24

Charles Stubblefield
Satellites Unlimited

Stephen L. Serafin
Signal Sources, Inc.

Rick Hawkins
Starpath of Hardin County

Cecil W. (Jack) Riley
Superstar Connection

Mark Brady
Uniden Corp. of America

Stanley E. Hubbard, II
USSB, Inc.

Staff

Vice President-
Government Affairs/
General Counsel
Mark C. Ellison

Vice President
of Marketing
Jerry Fischette

Director-Special Counsel
Anti-Piracy Task Force
Deppish Kirkland

VIA FACSIMILE

June 21, 1989

Mr. Jeff Almen
Director of Business Development
National Rural Telecommunications Cooperative
P.O. Box 994
Washington, DC 20016

RE: Restitution Calculation

Dear Mr. Almen:

As I mentioned during our conversation, we have been working with individuals at the Motion Picture Association of America and General Instrument Corporation to develop a restitution computation that can be used by Federal authorities in considering the restitution issue in criminal cases. The amount of restitution is based upon the average number of subscribed services per authorized VideoCipher. This figure is approximately 11 services (10.8).

To calculate the amount of restitution, we have selected a sampling of 11 typical services. The charge for these services is $35.45 per month.

As we discussed, this is a generic restitution calculation and should not be read to suggest that any customer is more or less likely to subscribe to any of the services actually used in the calculation. In other words, this collection of programming services is not selected based upon any data regarding actual subscriptions. We have merely made a random selection of what should be a typical package for the purpose of producing a monthly restitution figure.

A breakout of the subscription fees for the 11 services in the typical package are as follows:

225 Reineken Lane • Suite 600 • Alexandria, Virginia 22314

Service				Monthly Subscription
1.	HBO &	)		-
2.	Cinemax	)		$15.00
3.	WOR	)	Superstar	-
4.	KTLA	)	Connection	$ 3.00
5.	WSBK	)		-
6.	Disney			$ 7.45
7.	ESPN			$ 2.50
8.	USA			$ 2.50
9.	CNN &	)		-
10.	HLN	)		$ 2.08
11.	MTV			$ 2.92
				$35.45

We fully intend to point out that this number produces a conservative restitution estimate. For example, it does not nearly approximate the required monthly fees for access to all subscription programming. Nor does it include the cost of Pay-Per-View programming.

This monthly figure is then multiplied based upon whatever information may be available regarding the particular case in question. This information would relate to the number of units placed in the field and the period over which they may have operated.

I trust that this information will be helpful. Please let me know if you have any questions. As always, this is an evolving issue and your input would certainly be welcome. Best regards.

Sincerely,

Dep Kirkland/nlf

Deppish Kirkland
Director & Special Counsel
Anti-Piracy Task Force

DK:NLF(nrtc1.nlf)

MEDIA OWNERSHIP: DIVERSITY AND CONCENTRATION

THURSDAY, JUNE 22, 1989

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:10 a.m. in room SR-253, Russell Senate Office Building, Hon. Daniel K. Inouye (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR INOUYE

Senator INOUYE. The subcommittee meets this morning for its third day of hearings on media ownership and we now turn to issues of diversity and concentration in the broadcast industry.

Over the past 50 years broadcasters have been the subject of numerous constraints on what they can own. From the Chain Broadcasting rules of the 1940s, through the Multiple Ownership rules of the 1950s, to the various Crossownership rules of the 1960s and 1970s, broadcasters have had to limit their integration in the name of diversity.

The broadcast business, however, has changed over the past decade. Once you could be assured of reaching virtually all the American audience through just the three networks and that is no longer possible.

Once people thought that few Americans would pay for TV service, but over half of the country does so today. Once video cassette recorders were just commercial equipment. Now, two out of three homes has one.

The question before the subcommittee is whether these changes are so significant as to require revisions in the various ownership requirements.

The three networks argue, for example, that these changes have greatly reduced any market power they might have had, thus eliminating the need for the financial interest and syndication rules. This view is not shared by many others, including the movie industry, independent broadcasters and consumer advocates.

We have also heard from many local broadcasters that restrictions on the ownership of various outlets in the same community no longer make sense because of the large number of alternatives available. The public, however, may find these many outlets to be not true alternatives or simply not actually available.

The subcommittee intends to look behind these conclusory statements to determine whether market power exists and whether real efficiencies are present. So to assist us in this inquiry we are most fortunate to have leaders from broadcast interest, the programming community and the public interest sector, and in behalf of the Committee I thank all of you for being with us this morning and we look forward to your testimony.

Before I proceed, I am pleased to call upon my colleague from Oregon, Senator Packwood.

OPENING STATEMENT BY SENATOR PACKWOOD

Senator PACKWOOD. Mr. Chairman, I have a certain sense of deja vu when we start down this road, although the players at the table here are different. Mr. Valenti is not here, but I still see him out in the audience and his testimony is as lucid as it always was.

There is this difference, though, between now and 1983. This is a changed industry. I do not mean just ownership. It is a changed industry from what it was in 1983 and I think it is fair, therefore, that we revisit this issue not just, oh well, we have been down this road before, but almost look at it in an entirely new light in a circumstance that is totally different from what we faced six years ago.

Thank you.

Senator INOUYE. Now it is my pleasure to call upon the real leader of the Communications Subcommittee, the Chairman of the full Committee, Senator Hollings.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. I want to congratulate the chairman of the subcommittee, Mr. Inouye, for holding these important hearings on media ownership in America. These are the first complete Senate hearings on this subject in about ten years. Like the Commerce Committee's hearings on competition in the airline industry, these hearings are much needed. Deregulation may be bad enough, but without a competitive market structure, it is deadly.

It appears that media concentration concerns surface every twenty or so years. In the 1940's, the FCC initiated the first ownership rules for the broadcast industry, effectively creating the ABC network. We also had the Justice Department at that time break up the movie studio's hold on the local exhibition of movies. About twenty years ago, the FCC again adopted a spate of owership requirements, including the financial interest and syndication rules. The Justice Department followed a few years later with the consent decrees with the three television networks.

Now, many of these old rules have been changed, and there is constant pressure to make further alterations. The old boundaries are being torn down, and everybody wants to play in the other person's yard. Before this gets out of hand, we the Congress need to determine whether and where the market has failed, leaving some companies and industries with too much power.

You can tell just from the front pages of the newspaper that the structure of the media market is changing dramatically. We see Time and Warner try to merge, but than Paramount makes an offer to buy Time outright. We see the cable industry growing by leaps and bounds. Who would have believed ten years ago that more than half of the people in the country would pay to watch television. We see the three television networks in new hands, and we see their market share drop by over 20 points.

The structure of the media market is far different than even a decade ago, and more is to come. Much of this is due to the dynamism of this industry, particularly when coupled with the government's current "laissez faire" attitude. But, is there anybody out there who is asking what this means for the public.

We often say that an informed citizen is the heart of any democracy. But, if the media are controlled by a few, the odds of being informed drop dramatically. It is somewhat ironic to find that the number of media outlets is increasing while the number of owners is decreasing.

The subcommittee will use these hearing to map the new media landscape. I know many of my colleagues have concerns about the market power of the cable industry. Some have suggested we need to restrict the number of cable subscribers that can be reached, similar to the requirements now in effect for the broadcast industry. Others have recommended that we need to prohibit the owership and control of programming by cable operators, akin to the constraints on the television networks. There is still another camp that belives we should eschew regulation in favor of promoting new entry.

There are also many who are concerned about the rise of media conglomerates. It is feared that we may have a handful of companies controlling all the nation's media by the year 2000. It is also feared that many of our media will be in foreign hands and we will be beholden to them for our information. I would be troubled by such events.

I am on record as being a strong supporter of diversity and competition. In my mind, the burden is on those who believe there should be greater integration of media properties. They have the burden of demonstrating that significant efficiencies are produced by such integration.

Again, I wish to thank the chairman for holding these important hearings. I look forward to hearing the testimony.

Senator INOUYE. Senator McCain?

OPENING STATEMENT BY SENATOR McCAIN

Senator McCAIN. Thank you, Mr. Chairman.

I would just like to echo the statement expressed by my friend from Oregon. I think it is appropriate that the situation be reviewed.

In the last ten years alone we have seen enormous changes, whether they be in market share, number of media outlets, the whole satellite dish business has become a reality, whereas before it was an incredibly small part of America's, and particular rural America's, ability to be provided with entertainment.

I think it is appropriate for the committee to review the ownership rules. I noted with some interest that one of the witnesses here, Mr. Wright, was quoted, either accurately or inaccurately, as saying that America will be going more and more to paying for their entertainment.

I am not sure that that is good for America, since obviously some Americans are unable to afford paying for what they have grown to feel is their right to receive their entertainment over the airwaves dictated by their ability to purchase a television set. And as I mentioned at a previous hearing, there are now more television sets than there are homes with indoor plumbing.

I think it is important that we look at the issues in light of the fact that the networks' market share has decreased significantly.

I also think that the emphasis continues to be on the consumer and the responsibility that the networks as well as the cable people fulfill the basic obligation they have to provide the American people not only with entertainment but with news and information. The "must carry" issue continues to be one that I think this Committee will be investigating.

I also think, finally, it is well to note that apparently both the networks and the movie industry are very healthy. According to reports, the networks will be experiencing, I believe 6.9 percent compounded profits annually and clearly those of us who have seen the efforts of Hollywood this summer recognize that they are obviously doing very well as well. So I think that to have the impression that either industry is in serious trouble does not jibe with the facts.

I appreciate the time of the witnesses this morning. We look forward to their testimony and I thank you, Mr. Chairman.

Senator INOUYE. Thank you. Senator Gore.

OPENING STATEMENT BY SENATOR GORE

Senator GORE. Mr. Chairman, I want to commend you again for this outstanding series of hearings and I am glad to see such a distinguished witness list for this third in the series.

Yesterday's hearing on cable issues was quite provocative and I am looking forward to an equally informative session today. In my view, there is a clear connection between the issues we discussed yesterday and those facing the panels here today.

During yesterday's hearing, the committee heard compelling evidence of anticompetitive behavior by the cable industry against its competitors. Basically, cable is having it both ways with a natural monopoly and no regulation. This is compounded by rigid barrier of entry restricting the only entity that can provide any real competition. That is, the telephone company.

The issues facing today's witnesses amount to a high stakes contest to decide who will control what we now call free TV. I have long supported the financial interest and syndication rules to help maintain the balance between independent production of creative properties and network domination of the airwaves. I believe those rules have worked well, and I remain skeptical of efforts to abandon them, but I am interested in the statements today.

This is the big issue for these companies, but we should not lose sight of some other issues that are on the minds of our constituents, in particular the need to dramatically improve both the quantity and quality of children's television and programming and also the alarming increase in violent and explicit programming available to children.

At the core of our responsibilities on this Committee is the mandate and makeup of the FCC, which has arrogantly thumbed its nose at the Congress and the public for the last eight years in dogmatic zeal for deregulation at any cost.

Mr. Chairman, thank you again for holding these important hearings and I look forward to the testimony today.

Senator INOUYE. Thank you. Senator Breaux, would you care to make your statement?

Senator BREAUX. Thank you, Mr. Chairman. I would also join with your other colleagues on the subcommittee in thanking you for this excellent series of hearings.

With regard to the deja vu comment, having not served in this capacity in the other body I am not burdened by the lessons of history and so I come here with an uncluttered mind, I guess, in the sense that it is my first impression and I am looking forward to hearing from our witnesses in the rest of the hearings.

Thank you.

Senator INOUYE. Senator Gorton.

Senator GORTON. Mr. Chairman, in one venue or another you have provided this senator with a very exciting and diverting week. I am looking forward to these witnesses on this most important subject.

Senator INOUYE. Thank you, senator.

We are most pleased to have with us on the first panel a very distinguished group of American leaders: the President and Chief Executive Officer of NBC, Mr. Robert C. Wright; the Chairman and Chief Executive Officer of the Capital Cities/ABC Incorporated, Mr. Thomas S. Murphy; the President and Chief Executive Officer of CBS, Mr. Lawrence A. Tisch.

Gentlemen, I thank you for your presence here and we look forward to your testimony. Mr. Wright, would you care to begin, sir?

STATEMENT OF ROBERT C. WRIGHT, PRESIDENT AND CEO, NBC, INC.

Mr. WRIGHT. Thank you, Mr. Chairman and senators.

My name is Robert C. Wright and I am the President and CEO of the National Broadcasting Company.

I am pleased to be here today to discuss the critical competitive issues facing the television industry and to focus on a regulatory anachronism that is anticompetitive and harmful to free television and to the public interest.

We do not have equal competitive opportunity for all in the television industry today. Three companies—NBC, CBS and ABC—are denied the same chance in the marketplace enjoyed by cable networks for which the public must pay and by foreign purchasers of Hollywood studios.

This subcommittee is concerned with competition and diversity in these hearings and there is no issue more basic to that concern than the continued vitality of the free over-the-air broadcast system which Congress created 50 years ago.

So today I would like to argue for the following fundamental proposition. The free television system and our public and national interest would be best served by eliminating antiquated economic regulations that unfairly and uniquely shackle the three networks, and that promote not the public, but private interests.

The financial interest and syndication rules were adopted by the FCC almost 20 years ago. The rules were based upon the FCC's view of the television marketplace of the 1960s.

In prime time, NBC, CBS and ABC were watched by over 90 percent of the audience. Seventy-four percent of the dollars spent on television entertainment programming were derived from the three networks.

There were only 90 independent stations reaching only half of the country. There were no cable program services and only 4.5 million homes subscribed to cable. VCRs did not exist.

This view of the television marketplace is no more current today than the view of the known world before Christopher Columbus set sail.

Today there are over 380 independent stations covering 90 percent of the country. There is a fourth broadcast network called Fox. Over 55 percent of American homes subscribe to cable television and are offered over 80 different cable programming services. There are 54 million VCRs in use in this country and the average home today can receive 27 different channels of national programming.

What has this expanded new world of video choices meant for the three networks? It has eroded our share of the prime time audience from 90 percent in 1970 to 67 percent last season—22 percent per network. And it has reduced our share of television programming expenditures in the market even more dramatically from 74 percent in 1970 to 24 percent in 1988—down to 8 percent for each network.

In 1970 the FCC viewed the networks as a bottleneck between program suppliers and the audience. This is an outmoded and absurd notion today. The buyer's market of the 1960s has given way to the clear seller's market of the 1980s.

Despite the substantial change in the marketplace since 1970, these rules are still on the books. Of all the participants in our increasingly varied and dynamic video marketplace, only the three traditional free, over-the-air networks remain shackled by the regulations that restrict their ability to invest in their primary product, entertainment programming, and to compete in many aspects of the television production and distribution business. Only the networks are not being allowed full membership in an increasingly global and multi-dimensional industry.

Why should government policymakers care about the networks' ability to compete, produce, finance and distribute television programs? Because this is not just a dispute between two powerful industries. At stake here is the continued health and vitality of this country's free, over-the-air broadcast system.

The networks play a critical role in that system. They are its backbone. They provide universal free service to cable and noncable homes alike through locally-licensed, affiliated stations, stations that have also seen competition erode their viewing shares and advertising revenues.

Let me remind the subcommittee that the 25 percent drop in audience share experienced by the three networks since 1970 is nothing more than the sum total viewership lost by over 600 local television stations across the country.

Network service to these stations not only includes entertainment programs, national and international news and major sporting events, but advertising availabilities that generate the lion's share of each affiliate's revenue.

That revenue enables stations to fund local news, local public affairs and local service, that is the bedrock of the licensing scheme of the Federal Communications Act.

Unlike other delivery systems that charge the consumer and compete without regulatory restrictions, the affiliates and the networks operate under a mantle of public interest responsibility, yet this is the one delivery system that the government has chosen to hobble with antiquated regulation.

The only way NBC and its affiliated stations can meet the competition is by obtaining and presenting the most innovative, diverse, high-quality programming possible. This is becoming increasingly difficult, because the pay services are fast developing the financial strength to win talent programs and events away from free television. It truly is a bidding marketplace today.

In 1986, the revenues of this Nation's cable systems surpassed the revenues generated by all U.S. television stations and the gap has been widening. 1988 estimates show that at least six cable networks—six—each made higher profits than the CBS and ABC networks combined.

Cable services can obtain their programming in open marketplace negotiations with suppliers, structuring whatever deal the market will bear and whatever is commercially reasonable at the time. A network, on the other hand, may only license a program or rent a program for two broadcasts and hope for sufficient advertising revenues to cover its investment.

Without the rules, networks could invest more money in a greater number of programs, structure arrangements with suppliers that would permit more innovation, more risk-taking, and enhance our service to the viewer.

We could fund new sources of production that now have only the studios where you have to go for financing if you are an independent producer without sufficient clout to get the economics to support yourself. We cannot lend money to support and invest in programs that we do not 100 percent own.

Most importantly, increased network investment in programming would help strengthen the free television system's ability to compete against pay services for product, talent and audience.

The rules also harm America's position in the exploding international video marketplace. Only the networks, potentially this country's strongest competitors, cannot fully participate in the global arena.

We watch as the Australian News Corporation and Qintex buy up Hollywood studios, but the American networks cannot do what they do at home or abroad. We cannot produce programs in the

United States with foreign money and then export those programs. We cannot buy the foreign distribution rights to a theatrical movie if it has ever been on television.

About the only incentive or the opportunity we have, in fact, is to produce abroad solely for foreign markets, because that way we do not trigger the rules.

These few examples point out the absurdity of retaining rules designed for another era.

In 1983, after almost six years of painstaking fact-finding by two separate FCC commissions under Republican and Democratic administrations, the FCC decided that the financial interest rule should be repealed and the syndication rule relaxed until 1990, when it, too, would be eliminated.

This independent and impartial agency analysis found that the rules had not accomplished any public interest goals and had instead increased concentration in the program supply market and reduced investment in programming. The FCC based its conclusions on marketplace changes that were far less dramatic than those which have taken place since 1983. Every other independent government agency that examined this issue at the time—the Department of Justice, the Federal Trade Commission and the Department of Commerce—agreed with the FCC's conclusion.

Last year, NBC proposed a fair test of competition versus regulation that went only half the distance recommended by the FCC in 1983. We proposed that the rules be eliminated for only 50 percent of our prime time programming so that we could have marketplace experience without the rules for part of the schedule, and with the rules for the other part. We would see which better serves the public interest in the long term. The studios have failed even to respond to this proposal. They are not willing to test the merit of their arguments in the marketplace. Instead, the MPAA and other lobbying groups have formed a new political coalition to oppose any changes in the rules.

If negotiations do not succeed—and I do not believe the studios presently have any incentive to negotiate—then this issue should be addressed by the appropriate agencies on an updated record I believe we should try hard to resolve these issues in the next few months ahead and at the end of that time we owe you and others an explanation as to whether or not our negotiations were fruitful. If not, I think then it probably behooves us all to seek some sort of an updated record.

NBC does not seek special treatment. We merely want to be able to compete on an equal footing with all other program services offered to the public. Giving us this opportunity can only benefit our free television system and the viewers who enjoy and depend upon it.

Thank you very much.

[The statement and questions and answers follow:]

STATEMENT OF ROBERT C. WRIGHT, PRESIDENT AND CEO, NATIONAL BROADCASTING, CO.

Mr. Chairman and members of the Subcommittee, my name is Robert C. Wright and I am President and Chief Executive Officer of the National Broadcasting Company.

INTRODUCTION AND SUMMARY OF ARGUMENT

I am pleased to be here today to discuss the critical competitive issues facing the television industry, an industry that provides American viewers with the most abundant and diverse television service in the world. We think this level of service will continue so long as all the participants in this exciting business -- those who produce programming and those who distribute it -- can compete on an equal footing.

But we don't have equal competitive opportunity for all in the television industry today. Since this Subcommittee is concerned with competition and diversity in these hearings, there is no issue more basic to that concern than the continued vitality of the free over-the-air broadcast system. So today I would like to argue for the following fundamental proposition: The free television system and our public and national interest would be best served by allowing the vibrant, highly competitive marketplace of today decide how to allocate resources between the suppliers of television programs and the many outlets that buy those programs, including the three traditional networks. These vital interests are not served by the retention of antiquated economic regulations that unfairly and uniquely shackle these three companies and that promote not the public, but private interests.

Regulation is the exception, not the rule, in our free market economy, and there is no public interest justification in the video marketplace of today and tomorrow for regulating the networks' ability to invest in television programming and to share in the proceeds from subsequent uses of programs in which they do invest. In fact, these unnecessary regulatory restraints have stifled competition and diversity in the television industry for almost two decades. They are blatantly anti-competitive and contrary to the public interest.

The Financial Interest and Syndication Rules have their origins in the 1960's, when the three networks together purchased over 90% of the programs exhibited on television and were thought to be an unduly powerful bottleneck between program suppliers and viewers. The Rules prohibit a network from investing in programs produced by others, from sharing in the revenues from subsequent sales of programs that have appeared on the network, and from selling programs directly to stations in this country and, in most cases, abroad.

Today, a quarter of a century later, the 1960's view of the marketplace and the Rules is obsolete. There have been vast economic and technological changes in the television industry that have forever altered its structure and competitive dynamics. Today, the viewer has available a multitude of video services which compete with each network affiliated station and the network service.

Today, strong independent stations exist throughout the nation offering a variety of programs. Today, cable has become a major force providing diverse program offerings over a multitude of channels. Today, home video rentals are available in stores in every city, town, and village of the country.

The fundamental and essential change is that television viewers now have a huge variety of program sources to choose from and program suppliers have multiple, highly competitive buyers for their product. There is now not only tremendous competition for television product among the three networks, who have seen their overall share of audience decline over 25% since the Rules were adopted, but also between the networks and these many other distribution sources. In fact, each network today purchases only about 8% of the programming that appears in American homes. Put most simply, the buyer's market of the '60's has turned into a seller's market in the '80's and beyond.

But of all the participants in the increasingly varied and dynamic video market, only the networks are shackled by economic regulation. These antiquated regulatory burdens weaken the networks' ability to compete in this new world of audience choice, where independent stations and cable viewing continues to erode network ratings, and pay media gains the financial strength to outbid free television for entertainment and sports programs.

The public interest would clearly be served by deregulating the networks and allowing unfettered competition in the financing, purchase and distribution of television programming. Without the stifling effects of the Rules, the networks could invest more in programming, take more risk on new sources of production, seek greater quality and innovation and become more formidable competitors in the increasingly important global market for video programming. Network investment will make entertainment programming on free over-the-air broadcasting stronger, which will in turn strengthen the ability of networks and their local affiliated stations to present news, public affairs and sports programs.

Strengthening free television will benefit all Americans, but especially those poor, elderly and rural viewers who rely on local stations for their entertainment and information. The broadcast networks are the backbone of our free locally-based broadcast system. They support hundreds of affiliates across the country who are invested with the responsibility to serve the public interest. Networks also support creative talent, independent producers, independent stations, cable systems and national advertisers. All these important elements of the television business are benefitted by strong competitive networks. They all lose when networks are weakened.

The only interests now served by the FCC's economic regulation of networks are the private financial interests of a few: the major Hollywood studios who want to continue to be the primary source of

Program financing, and the foreign investors who are buying -- or who will buy -- these program financiers. To favor these special interests by regulating the networks -- the providers of universal free entertainment, news and sports programs -- is contrary to the interest of the public and our nation in an era of growing global, multi-faceted competition. The exploding video marketplace can best decide how program acquisition and distribution business relationships should be structured. Government interference in these marketplace forces is unnecessary and harmful.

Over a year ago, as part of their ongoing negotiations with the studios, the networks proposed a fair marketplace test of the benefits of competition versus regulation: that the Rules be eliminated for only 50% of the prime time schedule (about 11 hours). Although we strongly believe the beneficial effects of increased competition will occur if the Rules are eliminated, we are prepared to put that proposition to a marketplace test. If over a reasonable time frame there is no loss of program diversity or evidence of network abuse, the Rules would be repealed in their entirety.

The studios have offered no substantive response to this proposition. They are unwilling to test their rhetoric in the real marketplace.

If the Rules were not now in effect and a proposal to adopt them was made to the FCC or the Congress, there is no doubt that both policy making bodies would find such restrictions were unnecessary in today's marketplace; that they would not serve the public interest; and that, in fact, they would disserve the very goals that motivated their adoption -- diversity, viewer choice and competition. Changed conditions and clearer perceptions require repeal of obsolete Rules, particularly if they adversely affect the public. All the networks ask is for the freedom to take risks -- to succeed or fail before the American viewer and as a worldwide competitor. We seek no guarantee of success -- only the chance to attain it.

I. THE FINANCIAL INTEREST AND SYNDICATION RULES HAVE NO PUBLIC INTEREST JUSTIFICATION TODAY BECAUSE THERE IS FIERCE COMPETITION AMONG MULTIPLE BUYERS OF VIDEO PROGRAMMING AND DRAMATICALLY INCREASED VIEWER CHOICE.

A. The Rules Are Based On An Antiquated Perception Of Concentration In The Television Marketplace Of The 1960's.

The Financial Interest and Syndication Rules were enacted by the Federal Communications Commission (FCC) in 1970, almost 20 years ago. The Rules have their roots in the even more ancient past: the proceeding that led to the adoption of the Rules was commenced in 1965 and was triggered by the findings contained in a 1959 study of network program acquisition practices (the Barrow Report). The Rules themselves were predicated on studies of the mid-1960's television marketplace and rested on a simple "bottleneck" theory: that control over programming and access to TV stations was heavily concentrated in the hands of NBC, CBS and ABC; that this concentration supposedly limited effective competition for program suppliers' product and therefore decreased the diversity of independent program sources; and as a result, the three networks supposedly "dominated" what viewers could watch during prime time and had unfair leverage in negotiations with program suppliers.

This 1960's picture of the marketplace bears no resemblance to the world we compete in today. Moreover, with hindsight it is obvious that whatever network "control" and "concentration" was perceived by the FCC in 1970 was caused not by any predatory business practices, but by the structural and technical limitations of television distribution that existed at the time. Television was only delivered to the home over-the-air by local stations (a small number of cable systems existed to enhance over-the-air-reception). Programs reached the limited number of TV stations authorized by the FCC via AT&T landlines -- and there were only three national terrestrial networks. Yet the Commission dealt with these structural limitations by attempting to regulate one aspect of network-supplier business arrangements: networks'equity participation in programs produced by others and network sale of programs to individual stations.

Even assuming the patient was sick, this was not an effective or logical cure. It makes even less sense in the diverse and vibrant video marketplace of today. The patient is certainly healthy now, but the government is still applying the cure of archaic regulatory "leeches" that merely serve to sap the strength of our free TV system.

B. Enormous Economic And Technological Changes In The Television Industry Since 1970 Have Dramatically Increased The Number And Type Of Distributors And Buyers Of Video Programming.

Basic to all the reasons for repeal of the Rules is the enormous transformation that has taken place on the television industry over the past 25 years. This period has been one of massive and dynamic change -- technological advances, emerging new media alternatives, new competitors for viewers, new program purchasers. This dramatic change was not the result of regulation, but because of fundamental economic and technological forces that altered the structure of the industry. Yet although the factual and theoretical premises that supported the Rules have absolutely no validity today, assuming they ever did, the networks continue to be shackled by restraints that prevent them from being effective competitors.

1. The Significant Growth In The Number Of Broadcast Outlets, Particularly Independent Stations, Has Supported The Launch Of A Fourth Network And The Expansion Of The Syndication Market.

Changes since 1970 in broadcast television itself -- our traditional distribution technology -- have created new program options for viewers and substantial new opportunities for program suppliers. Over-the-air television stations have increased and flourished, with the number of stations on the air rising from 609 in 1970 to 1053 in 1988. The real growth, however, has been in the number and strength of independent stations, which today provide a non-network voice in over 90% of America's TV households. In 1970 there were only 90 independent stations; today there are over 380. Independent stations' viewing share has more than doubled since the Rules were enacted and their revenues have climbed to almost $2.7 Billion -- 25% of all TV station advertising and a 12-fold increase since 1970.

These strong independent stations have provided the foundation for the launch of a fourth network, Fox Broadcasting, which reaches 90% of the country and will offer viewers eight hours of prime time programs over three nights this Fall. Fox is a bona fide competitor to the other three networks for viewers (attracting 12% of the

Sunday prime time audience in February, 1989, and beating ABC and NBC in one time period), program product (spending over $100 million with major program suppliers) and advertisers (Fox became profitable in the latter half of 1988). Yet the Fox Network is not constrained by the Rules that inhibit NBC, CBS and ABC: it can and does finance and invest in programs produced by others, sell programs to individual stations and share in the revenues and profits of those sales.

The number and financial strength of independent stations has also fueled the growth of the syndication market, where programs are sold to individual stations on a market by market basis, and particularly the syndication of original programs ("first-run"), which was of special concern to the Commission in 1970. Domestic syndication is currently over a $2.5 Billion business. In the last five years alone, the number of first-run programs available to stations has gone from 45 to 113. As Paramount proved with its launch of "Star Trek: The Next Generation", first-run syndication now provides an efficient and financially rewarding way to produce and distribute expensive, high quality entertainment programming without the involvement of any of the three networks. This $1.3 million per episode show booked a profit in its first season in first-run and reaches over 96% of the viewing audience.

2. The Development Of Cable Television Since 1970 Has Increased Program Options For Viewers And Created New Markets For Suppliers.

Despite the importance of the growth of broadcast outlets, it is a non-traditional technology, cable, that has truly created the most fundamental change in the structure and competition of the television industry.

In 1970, 4.5 million homes subscribed to cable in order to obtain better over-the-air reception. Original cable programming was non-existent. In 1988 there were over 49 million cable subscribers comprising 55% of all television households. Over 86% of the country's viewers now have cable available in their communities. Over 80% of cable subscribers have at least 30 cable channels to choose from, and there are over 55 national and over 25 regional cable program services -- over 80 in all.

Cable has also become a major program purchaser, spending $2.5 Billion last year and, we estimate, almost $1 Billion on original programming. The trade press is full of accounts of the plans of cable networks to spend hundreds of millions on made-for-cable product. The USA Cable Network has announced it will spend $250 million on original programming; the Turner Network Television cable network is investing almost $300 million over three years for original films and specials; Lifetime Cable Network has commissioned at least three original series and is producing new episodes of "The Days and Nights of Molly Dodd"; HBO devotes over 35% of its schedule to original programming, including series, movies and specials. HBO spends as much as, if not more than the traditional networks on series episodes and made-for-cable movies.

Cable networks have also become major purchasers of shows that have already been on one of the broadcast networks, such as "Miami Vice", "Remington Steele", and "Murder, She Wrote".

This growth in the reach and purchasing power of cable was certainly not foreseen when the Rules were adopted 20 years ago and a wire to the home merely enhanced over-the-air reception. Its market presence today is significant, and its many program networks offer diverse viewing options and numerous markets for suppliers.

3. Technological Changes Were Critical To The Increase In Diversity of Outlets, Providing Suppliers With New Program Marketing Opportunities.

Technological change has had an enormous impact on the face of the television landscape since 1970. First and foremost, beginning in the mid-1970's satellite delivery of programming forever broke the terrestrial distribution logjam that tied stations to one of the three networks. Today virtually every station, affiliates and independents alike, has one or more satellite dishes capable of receiving programs from a myriad of different sources. Satellite delivery also made possible the creation of original cable program networks, like HBO, which spurred cable penetration beginning in this decade. Cable carriage was also a major boon to independent stations, particularly UHF independents, where most of the growth in numbers and viewing occurred.

When the FCC adopted the Rules in 1970, many of the distribution technologies that seem commonplace today did not exist at all. Video Cassette Recorders were not a consumer product as recently as 10 years ago, but they are now found in over 53 million homes. There are thousands of video stores, offering hundreds of titles to the public, which spent over $8 Billion on cassette rentals and purchases last year. Of the homes that don't subscribe to cable, over 2 million get programming directly off a satellite with a backyard dish.

There are 750 low power television stations, serviced by about a dozen national low power TV networks, providing an alternative program outlet in communities across the country. Everywhere you look new distribution technologies have led to an explosion in the number of program sources and choices available to the American viewer and the number of buyers of program product. The network "bottleneck", if it ever existed, is gone. Today the average American home can receive 27 different channels of programming, in contrast to 7 when the Rules were enacted, and each one is a potential customer for program suppliers.

THE CHANGING TELEVISION MARKETPLACE

	1970	1983	1988
GROWTH OF DISTRIBUTION OUTLETS			
TOTAL TV STATIONS	609	802	1.053
INDEPENDENT STATIONS	90	179	381
CABLE SUBSCRIBERS (% TVHH)	4.5M (7.6%)	28M (33.7%)	49.2M (55.2%)
CABLE PROGRAM SERVICES	0	51	85
NUMBER CHANNELS RECEIVED BY AVERAGE TV HOME	7	10	27
GROWTH OF NON-NETWORK PROGRAM EXPENDITURES			
DOMESTIC SYNDICATION	$223 MILLION	$1.24 BILLION	$ 2.5 BILLION
CABLE NETWORKS	0	$ 900 MILLION	$ 2.5 BILLION
FOX NETWORK	0	0	$ 100 MILLION
DECLINING COMPETITIVE POSITION OF NETWORKS			
PRIME TIME VIEWING SHARE	90%	76%	67%
SHARE OF TV ADVERTISING	48%	43%	37%
3-NETWORK PROFIT MARGINS	15.4% (1977 HIGH POINT)	8.3%	4.0%

C. Competition Among The Growing Number Of Distribution Outlets Has Turned The Buyer's Market Of The 1960's Into The Seller's Market Of The 1980's And Beyond.

1. Increased Competition For Program Product And Audience Has Diminished The Competitive Position Of The Networks.

Each of the three traditional networks must compete for the most attractive program product and for audiences to sell to national advertisers. The multiplicity of program distribution outlets that has burgeoned over the past 20 years has inevitably intensified competition in both arenas.

As for program product, the buyer's market of the 1960's has given way to the seller's market of the late 1980's. And, with this shift, the importance of the three networks as purchasers of television programs has been significantly diluted. In its 1983 Tentative Decision to repeal the Rules, the FCC found that each network accounted for about 18% of the dollars spent on entertainment programs that appeared on television. Using essentially the same measurements, that figure last year had dropped to about 8% for each network -- hardly a level that conjures up the "dominance" or "unfair leverage" recited by the Commission 20 years ago. The FCC's 1970 concern that one of the three networks was a program supplier's only route to the prime time audience is an anachronism today. Suppliers can now distribute their programs direct to stations via first run syndication, to a fourth network or to dozens of basic and pay cable networks.

As for the competition for audience, this brave new world of multiple viewer choices has taken its toll on the competitive standing of the traditional broadcast networks, who now compete not only against each other, but against independent stations, cable, home video and other delivery systems.

2. The Three Networks Compete Fiercely Against Each Other.

When we talk about the networks in relation to this or any other issue, we tend to lump the three of them together as though they were a single monolith, acting as one. Nothing could be further from reality. Despite the proliferation of other viewer choices, each network still views the other two as a significant competitor for viewers, programming, talent and advertising. Why else would we spend millions of dollars bidding against each other for the Olympics and Major League Baseball, or for on-air talent like Diane Sawyer, or creative talent like Stephen Bochco? Why else would we ballyhoo tenth of a point ratings victories to our advertisers? The three of us are commonly disadvantaged by these Rules, but that's where our commonality of interest ends.

3. Continued Competition Among The Networks And Increased Competition From Alternative Media Has Caused Networks' Audience And Revenue Shares To Decline Considerably.

The addition of new services vying for the home viewer's attention has only caused the competitive battle for viewers intensify, as the audience becomes more difficult to attract and retain. It's not that people are watching less television; in fact they are watching more. It's that as more viewers have more choices, they watch less network television. The networks have seen their combined share of prime time viewing drop to 67%, quite a change from the 90% that prompted FCC action in 1970. On a total day basis networks account for only 36% of viewers' time, a 27% decline from only eight years ago. Thus the average network attracts only 22% of the audience in prime time and only 12% of the audience throughout the day. In contrast, independent stations' share of total day viewing has risen to 18% and basic and pay cable services, non-existent when the Rules were adopted, now account for over 22% of all viewing. Networks' audience "dominance" is clearly a thing of the past.

With declining network viewing shares has come lower shares of advertising revenue, exacerbated by an overall slowdown in the growth of advertiser spending on networks. Since 1980, the networks' share of TV advertising has dropped 20%, from 46% to 37% of the market. Since 1985, the annual growth rate of network revenues has been essentially flat, with the exception of the extra dollars generated by last year's Olympics. Cable and syndicated shows on independent stations have again been the beneficiaries. National ad revenue dedicated to syndicated programs today equals almost $1 Billion and, together with ad revenues generated by cable, the fastest growing TV advertising medium, accounts for 11% of the total TV advertising market.

Viewer erosion and loss of advertising share have, in turn, impacted the profitability of the three networks, who have seen their combined average profit margins tumble from 15% in 1977 to about 4% in 1988. One of the three network businesses, ABC, reportedly lost money last year. The CBS Network was only marginally profitable. NBC's Network enjoys healthy profits, but only because of the current (and fragile) success of its prime time schedule. By our estimates network television has the lowest profit margins in the media/entertainment business, surpassed by studios (11%), cable systems (44%) and cable networks (29%), major network advertisers (18%) and large market TV station affiliates (39%).

4. Pay Media, With Two Revenue Streams, Are Becoming Financially Stronger Than The Free Media.

Not surprisingly, this decline in the traditional networks' competitive position has reduced their ability to develop and bid for programming against their new media competitors. The networks' economic picture is in stark contrast to the increasing financial health of this competition, especially pay media, which can tap into direct subscription payments by the consumer as well as advertising revenues, and which are without the regulatory restraints that burden the free system. Last year it was estimated by media analysts that HBO, Showtime, ESPN, CNN, WTBS, Nickelodeon and MTV each made greater profits than the ABC and CBS Networks combined. All but one of these program services is entirely or partly owned by a major cable system operator, who can plow the cash generated by its local systems into program acquisition. In this regard, beginning two years ago, the revenues generated by this nation's cable systems exceeded those generated by the sum total of all free over-the-air broadcast stations, and the gap is widening as time goes on.

Is it any wonder that, more and more, programs that used to be on free television are moving to pay -- theatrical films, major sports events and, more recently, off-network entertainment series.

5. The Trends Experienced by Networks Are Not Expected To Change In the Future.

The competitive challenges the networks face are not going to get any easier and the trends our business has experienced over the past decade are likely to accelerate; they certainly won't be reversed. Cable penetration is expected to reach 60% by the end of the decade and with it will come more fractionalization of the audience and more subscription dollars available to pay media for program acquisition. The amount and intensity of competition for advertising revenues will continue to grow. The rising cost of providing attractive entertainment programs, international news and major sports events will put increased pressure on network profit margins.

Networks can only meet the competition of the 1990's by continuing to attract viewers, and that will require us to offer the most innovative, diverse, high quality programming possible. But of all the worldwide participants in this increasingly varied and vibrant video marketplace, only the three traditional over-the-air networks are shackled by regulations that restrict their ability to invest in their primary product -- entertainment programming -- and to participate and compete in the many aspects of the television production and distribution business. In the world, only the networks cannot fully be a part of this increasingly global and multi-dimensional business.

Why should government policy makers care about the networks' ability to produce, finance and distribute television programs? Because this is not just a dispute between two powerful industries. Because the continued health and vitality of this country's free over-the-air broadcast system is at stake. Because removing these regulatory shackles on the networks -- the backbone of that system -- will strongly promote the public interest and the consumer.

II. REMOVING THE REGULATORY SHACKLES ON THE NETWORKS' ABILITY TO INVEST IN PROGRAMMING WILL STRONGLY PROMOTE THE PUBLIC INTEREST.

A. Networks Play A Critical Role In The Free Over-The-Air Broadcast System.

No one can dispute that the networks play a critical role in our nation's television scheme. They provide universal, free television service to virtually every home in America. This is of particular value to the 45% of TV viewers who do not subscribe to cable, many of whom are poor, elderly or rural citizens. Those Americans unable to afford the pay media depend on the free networks for high quality entertainment programming, for national and international news and for major sports events.

Networks are the backbone of our system, because of the relationship they have to over 600 local affiliated television stations across the country. There is no way these stations, particularly those in markets below the Top 100, could in any other way acquire the kind of programming they now receive for free from one of the three networks. The communities in which these stations are located are too small to be of primary interest to the national program suppliers or syndicators that sell programs market by market, and even if there was supplier interest, these stations do not generate sufficient revenues to be able to afford premiere sports events or many hours of expensive entertainment product. Affiliates in the bottom 100 markets, if they make money at all, achieve only single digit profit margins.

Networks do more than supply all their affiliates in all sized markets with programming that would otherwise be out of many stations' reach. The advertising revenues generated by local commercials in network programs constitute the lion's share of most stations' profits and help to fund the local news, local public affairs and local service that is the bedrock of the local licensing scheme of the Communications Act. Unlike the other delivery systems that compete without regulatory restrictions, the stations affiliated with and owned by each of the three networks operate under a mantle of public interest responsibility. And, because of our affiliates and our long-standing view of our relationship with them and the viewing public, networks also operate with a view toward their responsibility to serve the public interest. It is both ironic and illogical for the government to hobble the competitive freedom of the one program delivery system in this country that is not only free to all, but which is mandated by law to serve the public. Neither the studios that produce programs nor the delivery systems for which the consumer must pay shoulders this responsibility.

Network programming is also the backbone of our system in other ways. The most watched channels on cable are network affiliates, and the ability of cable systems to offer subscribers good reception of these local stations has and continues to support that industry's growth. A large part of the syndication market consists of programs that were originally on, and funded by, one of the networks.

Weak networks, constrained in their ability to invest in entertainment programming, are not in anyone's interest. Local affiliated stations need a strong and competitive national program supplier. Cable relies on the strength of network programming to attract and retain subscribers. Independent stations rely on off-network product to win audiences. Program suppliers depend on networks to fund program development and production costs. Given the critical role of the network program service for all these participants in the television business, there is no public interest rationale for government interference in networks' ability to finance, develop and produce programming.

B. Networks Must Be Permitted To Invest In Programming In Order To Remain Competitive.

1. The Rules Restrict The Amount Networks Can Spend On Programming.

Under current restrictions dictated by the Rules, networks are only permitted to license a program from a supplier for network exhibition. They may not be investors or equity participants in a program and participate in the revenues or profits generated by that program in domestic or international syndication. Thus the networks must depend entirely on advertising revenues to cover the cost of licensing the program (which covers all the studio's development cost and 70-100% of its production costs), and to yield any profit.

As network advertising revenue growth flattens, and as a greater number of competitors vie for the available pool of ad dollars, the networks' ability to cover cost and generate some profit has become increasingly difficult. The networks are thus inevitably constrained in the amount they can spend on developing new programs, funding new sources of production, taking risks on new program ideas and enhancing the quality of what is already on the air.

The impact of the Rules on the networks' ability to present innovative television is not theoretical. The recent example of "The Days and Nights of Molly Dodd" proves my point. "Molly Dodd" was creatively different from the typical half-hour sitcom and received much critical attention and acclaim. Nevertheless, NBC cancelled the show after one season because its ratings, which were mediocre, did not generate sufficient advertising revenue to make renewal economically sensible. The program was picked up by the Lifetime Cable Network which, because it is not subject to the Financial Interest or Syndication Rules, was able to structure a deal with the producer whereby Lifetime shares in both the cost of production and the future profits of off-cable syndication. Lifetime acknowledges that it will run "Molly Dodd" on its cable network at breakeven, but can look to future syndication revenues for its returns.

So, by government edict, a service for which the viewer has to pay can invest in distinctive, innovative programming, and take the risk that the show will succeed or fail on both its network and in the aftermarket, while the free over-the-air networks must consistently opt for lower risk programs that quickly attract large numbers of viewers and ad dollars. The public policy benefits of this scheme are a mystery to me.

2. The Public Would Be Served If The Networks Were Free To Make Investments In Programming On Marketplace Terms.

The public would be greatly served by eliminating these Rules and allowing unfettered competition in the financing, production and distribution of television programming. Without the Rules, networks could invest more money in a greater number of programs, structure arrangements with suppliers that would permit more innovation and risk-taking, and enhance our service to the viewer. We would fund new sources of production that now have only the studios as a source of financing. Increased network investment in programming would also benefit the production community (especially independent producers), creative talent and even cable and independent stations that rely on product that originally aired on one of the networks. And the networks would continue to have the resources not only to provide high quality, innovative entertainment programs, but worldwide newsgathering operations that support national and international news and world class sports events like baseball, football and the Olympics.

Most importantly, if the Rules were eliminated, the Networks would be better able to compete for programming against pay services and other video competitors which are not constrained by regulation. The government prevents only the networks from negotiating marketplace arrangements for the development and acquisition of programming -- from seeking returns from several revenue sources. This handicaps the free broadcast networks' ability to compete with the pay media, which can fund programming with subscriber fees, advertising and participation in domestic and foreign syndication revenues. The networks are permitted to have only one revenue stream -- advertising -- and therefore may have to bid less for programming. This handicap may accelerate the growing movement of popular entertainment and sports from the free television system -- where they are available to all -- to the pay media, where they are available only to those who can afford them.

C. Deregulation Will Unchain A Major U.S. Competitor In The Expanding International Market.

Deregulation would also serve the public interest by giving the networks the ability to compete in the exploding international marketplace. Foreign syndication revenues amounted to over $1 Billion in 1988. The number of foreign program channels that can buy American product has almost doubled in the last 3-4 years and co-production ventures between multi-national partners is a growing trend. Yet the FCC Rules restrict three and only three companies, potentially America's strongest competitors in foreign markets, from full participation in the global arena.

American networks can't do in foreign countries what foreigners can do here. Nor can we do what pay media can and are doing around the world. Networks cannot invest in foreign co-productions the way foreigners can invest in American co-productions. We can't syndicate others' programs abroad, although companies like Qintex syndicate here. We can't produce programs in the U.S. with foreign investors' money and exploit those programs at home and abroad. In fact, the

Rules create an incentive for the networks to produce abroad solely for foreign markets, because if no dollars are spent here and no programs are broadcast here the Rules are not triggered.

This result can hardly be in the public interest; I'm sure it was not intended by the framers of the Rules, who did not contemplate the global media marketplace of the 1980's and beyond. But the Rules persist, even while these limited examples demonstrate the absurdity of retaining regulation designed for another era. They weaken three major American competitors at home and abroad, and reduce the amount of foreign money that could potentially flow into our domestic entertainment industry. Of all the illogical and harmful results of the Rules, the ones that reach abroad are the most egregious.

* * *

We believe the Rules are clearly against the public interest. They are harmful to the free television system and hamper international competition by American companies. We also strongly believe that from the standpoint of competition and service to the public, repeal of the Rules would be extremely beneficial: Networks would invest more in programming, strengthen their program service, enhance their news and sports offerings, remain competitive against pay media and add to America's strength in the global market. But we cannot prove that these benefits will flow from repeal because the Rules remain in place. That is why we have proposed a true marketplace experiment that will test the results of regulation versus competition. Before describing that proposal, let me try to answer the arguments you will probably hear against any change in the Rules.

III. CONTINUED ECONOMIC REGULATION OF THE NETWORKS ONLY PROMOTES PRIVATE INTERESTS.

The only entities served by the Rules today are a few large, vertically integrated Hollywood studios, who want to continue to be the sole source of program financing, and the foreign investors who have bought or want to buy these program financiers. The studios have no interest in seeing the three networks compete for the ability to finance existing creative talent or emerging talent. They like the fact that three natural competitors -- NBC, ABC and CBS -- are forbidden by the government from participating in many aspects of television production, financing and distribution. They like the competition-free preserve this "special interest legislation" has created. The studio's dire predictions of a return to network "dominance" are nothing more than lame attempts to protect their private interests -- to be a necessary conduit between independent producers and creators of TV programs and the viewer. If the studios tried to achieve the effects of the Rules by private agreement, the result would be so blatantly anti-competitive that the antitrust laws would be violated.

A. The Major Studios Want To Preserve A Competition-Free Environment For Program Financing.

1. Studios Have Considerable Leverage In Bargaining With Networks

Let's not confuse these large, vertically-integrated studio conglomerates with a starving author in a garret. The studios are paradigm global, multi-faceted competitors that succeed very well in this business. Paramount, for example, is in theatrical and television production and distribution in the U.S. and abroad, it owns 50% of the USA Cable Network, it is a distributor of home video cassettes around the world, it has an agreement to purchase 5 TV stations, controls theaters in the U.S. and Canada, and owns several sports teams and beauty pageants. It has recently launched a bid to acquire Time, Inc., with its cable interests (i.e., HBO and many cable systems) and publishing business. Paramount thus competes in every aspect of the business -- producing/owning software, programming a channel, distributing via every available outlet. The other major studios have similar profiles.

To say companies like this have no leverage in their dealings with the networks, particularly when they bring proven talent or an already successful program to the table, blinks reality. With the fierce competition among the three networks and the newer distribution media that exist today, if a packager doesn't like the deal offered by one, there are many other potential buyers to choose from. ABC rejected the "Cosby Show" and so, fortunately, it ended up on NBC. NBC did not agree to the deal requested by the creators of "Roseanne" so, unfortunately, it's on ABC. The networks didn't offer Paramount a high enough license fee for "Star Trek", so it's in first run syndication. The networks weren't interested in "It's Garry Shandling's Show" so it's on Showtime cable network and Fox. The networks aren't the only game in town anymore. The proverbial "Three Men In New York" who, it was said, decided what America would watch on television have become dozens of program buyers and decision-makers. The studios, least of all, need help from the government to compete. And government assistance is especially misguided when, as I have detailed, it causes harm to the viewers of free television.

2. Studio Arguments Against Repeal Are Stale And Contrary To Fact.

There are no countervailing reasons to keep these Rules. The predictions of doom and the other arguments the studios routinely make against repeal are outdated, without merit and motivated by their own private interests.

For years the studios have been making the same tired arguments against repeal. First, they argue that if the Rules are repealed, we will return to an era of network "dominance". But no matter what any of the networks do, this country will not return to the television industry of the 1960's -- the then world of only 600-odd TV stations, no satellites, 4 1/2 million cable homes, no cable networks or VCR's, seven viewing choices per home. That era is gone, replaced by a competitive world of diverse video services, all hungry for program product.

Moreover, even in what the studios would have you believe were the "bad old days" prior to 1970, the networks did not engage in the kind of abuse the studios claim they will pursue if the Rules are lifted. The FCC found no evidence of "extraction" of profit shares or syndication rights when it adopted the Rules. In fact, the networks paid suppliers for financial interests and held such interests only in about half the programs licensed (not the 93%

often erroneously cited by the studios). There was no evidence the networks biased their program selection in favor of these shows, or held programs in which they held syndication rights off the market to advantage their affiliates ("warehousing"). This is not surprising, for to do either is simply bad business. The negative economic consequences of a poorly rated program on the network cannot be offset by some share of speculative syndication revenues. And a flop on the network is unlikely to be a hit in syndication in any event. The networks' track record in cancelling in-house productions that failed to win audiences should belie this theoretical notion of bias.

As for "warehousing", even assuming the networks could achieve any modicum of control of the syndication market today's highly competitive environment, their obvious self-interest would lie in maximizing aftermarket sales, which means getting a program to market as quickly as possible and selling to independent stations -- syndication's best customers.

Second, the studios also argue that the growth and health of independent stations and the syndication market are directly attributable to the Financial Interest and Syndication Rules -- that the Rules have worked. The truth is that these Rules had nothing to do with the changes in the television marketplace we live with today. Instead these changes can be directly traced to the economic recovery this country experienced in the mid-1970's (5-6 years after the Rules were enacted), which drove television advertising to new heights, up 116% between 1975 and 1980 -- and to the sweeping technological and structural changes in the industry that I detailed before.

Government regulation of network-supplier relations has been irrelevant to the explosion in media diversity. Marketplace forces fostered that growth and will continue to shape the future of the video industry.

Third, the studios will remind you that in the early 1970's the FCC and the Justice Department found the Rules were necessary to foster competition and protect the public, so the burden of proof is on the networks to show that change would serve the public interest. They conveniently neglect to mention that in 1983 both the FCC and Justice found the public interest would be served by repeal of the Rules. In any event, assuming we have the burden of proof, the networks have clearly met it.

Fourth, we hear that networks (or their parent companies) make plenty of money and therefore don't need regulatory relief on that basis. The fact that networks' parent companies derive profits from other businesses is irrelevant. The major studios also enjoy profits from many sources other that television production. The network business is now a money-losing or marginal proposition for two of the three. But more importantly, the issue is not who makes money, but whether keeping the free over-the-air broadcast system strong is in the public interest.

These and the studios other stale arguments are without merit and should be heard with their real motivation in mind -- protecting their private position in the program financing and distribution marketplace.

B. Foreign Purchasers Of American Studios Are Also Insulated From Competition By Virtue Of The Rules.

In the past year, several foreign entities have purchased American film production companies, including MTM Productions (TV South - Great Britain), The Cannon Group (Pathe - Italy) and United Artists (Qintex - Australia). Rupert Murdoch, through his Australian-based News Corporation, has owned the Fox Studios since 1985. It is rumored that the Japanese are eyeing Columbia Pictures and MCA. The Rules protect even these foreign-owned companies against competition from the American networks.

The television business has evolved into a world inhabited by large vertically integrated global companies. In explaining the rationale for his company's proposed merger with Warner Communications, Time Inc.'s Richard Munro said that the newly created entity would have the ability to compete in all the key production, programming and distribution markets and to take advantage of new global opportunities. This ability, he recognized, is essential to success and even survival in the 1990's and beyond. If the networks cannot fully participate in all aspects of our own core business or in the international marketplace, our chances for long-term success as free over-the-air program services are slim.

And our failure will benefit neither this nation's television viewers nor America's overall competitiveness as we move into the next decade.

There is no rational reason to retain these Rules. So it is hardly surprising that all of the government entities that have looked at the Rules in recent years have also concluded that they should be eliminated. Let me remind you of their findings.

C. The FCC And Other Government Entities Concluded That The Rules Should Be Repealed On The Basis Of Less Significant Marketplace Change.

In 1983, as a result of the changes in the marketplace and the networks' diminished competitive position, and recognizing that the Rules had not and would not serve the public or their stated purpose, the FCC decided to repeal the Financial Interest Rule and relax the Syndication Rule. The Commission relied heavily on the conclusions and recommendations of its Network Inquiry Special Staff, which had been appointed by Chairman Ferris during the Carter Administration to study network program acquisition practices.

When the FCC reached its decision six years ago, the evidence of change was not nearly as compelling as it is today: there were 200 fewer independent stations making $1 Billion less in revenues; the Fox Network didn't exist; cable was only in 34% of the nation's homes; there were only 2 million VCR's in use; the average home received 10 signals -- 17 less than today; the three-network share of prime time audience was 76%, 12% greater than in the just completed broadcast season. Yet the Commission recommended repeal in the public interest.

The Commission's decision was supported by virtually every governmental body that examined the issue, including the Department of Justice, the Federal Trade Commission and the Department of Commerce. Since these expert agencies recommended repeal in 1983 the changes in the structure and competitive nature of our industry have again been enormous. Whatever favorable position the networks may have had 25 years ago, today they are each merely one of many buyers of television product, one of many competitors for viewers' attention, one of many national outlets for advertisers. The Rules nevertheless remain in place as though none of these changes had occurred.

IV. THE NETWORKS' ELEVEN HOUR PROPOSAL IS THE BEST NEAR-TERM SOLUTION

A. The Eleven Hour Proposal Is A Marketplace Test Of Regulation Vs. Competition

Over a year ago I proposed a very fair test of competition versus regulation by suggesting that the Rules be eliminated for only 50% of the prime time schedule (approximately 11 out of 22 hours a week). The 11 hour limit would cap networks' ability to acquire financial interests and engage in in-house production. We could engage in foreign syndication but, in domestic markets, could syndicate only programs produced by our owned television stations.

I truly believe this so-called 11 Hour Proposal is the best and fairest way to test the effects of deregulation. If over a reasonable period there is evidence of abuse or a decline in program source diversity, the Rules can be reimposed; if not the Rules would be repealed in their entirety in 1995. "Regulated" hours could be evaluated side-by-side with "unregulated" hours. The producers would permit us flexible deal-making for half the network schedule, and we would give up unlimited in-house production in 1990. My proposal would test the market. We will be able to see how and whether it works and what is in the public interest.

2. The Studios Will Not Test Their Arguments In The Marketplace. Their Goal In Negotiations Is To Maintain The Status Quo

In 1983, Congress asked the networks and studios to enter negotiations to try privately to resolve the issues surrounding retention, modification or repeal of the Rules. These negotiations have continued on and off over the years and resumed most recently over a year ago. To be frank, the pace and substance of these negotiations have been extremely frustrating and disappointing. The studios simply have no incentive to seek any compromise solution that would involve a change in the status quo so beneficial to them. They have failed to respond to the year-old 11 Hour Proposal except with pejorative labels. Unlike the networks, they are unwilling to test their arguments against repeal in the marketplace. Their response is to form "The Coalition to Preserve The Financial Interest and Syndication Rule" -- hardly signalling a willingness to negotiate in good faith or to compromise.

NBC is willing to continue these negotiations. We hope the studios will turn to the real issues involved and provide a substantive response on the 11 Hour Proposal. Because of the public issues involved, I urge this Subcommittee and others who are vested with public interest responsibility, to be concerned about this matter.

CONCLUSION

The networks do not seek special interest legislation, but merely seek the ability to compete on an equal footing with all the other program services offered to the public. We want to be able to make the same investments, take the same risks, and succeed or fail in the viewer's home with the best programs we can offer. Giving the networks this opportunity can only benefit our overall free television system and the viewers who enjoy and depend on it.

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS THERETO

Question: We heard that the key to controlling the media marketplace is control over programming. We therefore understand your incentive to have the FCC repeal its financial interest and syndication rules. But, you still have a prime time share of 65% to 70%. Doesn't this indicate you still have market power in the acquisition of programming?

Response: It is totally inappropriate to add together the prime time audience share of each of the three networks and then to claim that these combined shares constitute "market power". This has never been the test for any industry. The three networks are no more of a monolith than the three major auto makers or the three top computer companies. In fact, like the participants in those industries, they compete fiercely against each other for talent, programming, sports events, advertisers, affiliates and for every rating point.

Each of the three network competitors on average attracted only 22% of the prime time audience last season, not 65 to 70%. Moreover, each network's audience share is really nothing more than the combined viewership of over 200 affiliates in local markets who bring audiences to their respective networks with strong local news and other locally-originated programs.

It is also not fair or correct to confuse "market power" with popularity. People watch network programs because they choose to -- not because they have no alternatives. When the Financial Interest and Syndication Rules were adopted, the average television home had only seven program outlets to choose from, three of which were local network affiliates. Only the networks achieved national coverage through the AT&T terrestrial distribution system. Given this limited diversity of choice and the unique national reach of the networks, the FCC in 1970 was concerned about lack of viewer options and lack of effective competition for program suppliers' product.

Today the average home receives 27 different channels -- a wealth of viewer options, which provide competition for the networks. The terrestrial distribution logjam has been shattered by satellite delivery and today there are dozens of national program services, including the Fox Network, syndicated networks and cable networks. All these services compete for audience attention and for suppliers' programming.

The fact that the majority of viewers with access to these many choices continue to opt to watch the programs offered by the three networks does not diminish the diversity that exists or the degree of competition the networks face. This popularity only indicates that the networks have to date been able to provide viewers with more attractive programs than the competing choices.

Popularity does not confer monopsony buying power and has little or no impact on a program buyer's ability to purchase product. Network competitors such as News Corporation's Fox Network, Time Warner's HBO, Viacom's Showtime and Paramount/MCA's USA Network certainly have the resources to compete against NBC, CBS and ABC in the program acquisition marketplace, even though these services attract fewer viewers.

Besides, the relative popularity of network programming is declining. There has been a steady erosion in both aggregate and individual network viewing shares as audiences turn to the many other video choices available. The common wisdom is that this trend will continue as cable and other viewer choices continue to fragment the audience and erode network viewing.

Question: Who else buys "prime time" type programming? How much?

Response: NBC furnished the Subcommittee Staff with estimates of the 1988 expenditures and purchaser market shares for all entertainment programming. (Another copy of that analysis is attached for your reference). It is difficult to break "'prime time' type" programming out of the mix of total entertainment programs because so many different program types are broadcast in that daypart: series, made for TV movies, mini-series, theatrical movies, specials, etc. Even with that definitional problem in mind, it is clear that, unlike 20 years ago, there are many purchasers of these program types other than the three networks.

The trend in program acquisition is clearly toward a substantial increase in the number of other buyers and the dollars they spend. As the material previously submitted indicates, today each network accounts for only 8% of entertainment program expenditures, down from 25% when the Rules were adopted. Since the bulk of those costs, for both networks and other outlets, are dedicated to "'prime time' type" programs, it is likely that networks' share of that narrower market has experienced a similar decline over the past two decades. In fact, if we estimate that about three-fourths of network entertainment program expenditures are currently devoted to the prime time schedule, each network's spending for prime time entertainment constitutes only 6% of the total $12.4 Billion market -- not an indication of undue or concentrated purchasing power, and certainly a spending level achievable by the other major players in the business. In any event, the precise dollars spent and market shares they represent are not the critical factor; rather it is that program suppliers have many alternative buyers for their product:

- Cable networks are increasingly purchasers of expensive "network quality programs"

  -- 37% of HBO's schedule consists of original programming, including five current "network quality" series programs and two series planned for the Fall. HBO's "Tales from the Crypt" series costs $800-900,000 per episode, comparable to similar programs on network television. The Showtime cable network also presents at least four ongoing entertainment series, such as "It's Garry Shandling's Show", which also appears on Fox.

  -- HBO spends $4.5 million for each of its made for cable movies, 50% more than the average made for television movie license fee spent by the networks.

-- Basic cable networks have committed to spend hundreds of millions of dollars on original programs over the next two or three years. USA has announced a $250 million budget for original series and movies; Turner Network Television will spend almost $300 million on original movies; Nickelodeon has increased its budget for original product by over 300% since 1986; and Lifetime is presenting new episodes of "The Days and Nights of Molly Dodd" which originally appeared on NBC.

- First-run syndication has become an economically viable alternative to network distribution. For example, Paramount has three successful entertainment series in first-run, all of which ranked among the Top 20 syndicated programs last season. "Star Trek: The Next Generation" reportedly cost Paramount $1.3 million for each one-hour episode, yet because of its success it was profitable in its first year of syndication. Viacom's entry in first-run entertainment series is "Superboy", which also has a network-like budget of $450,000 for each half-hour episode. Lorimar's entertainment series "Mama's Family" has also been successful in first-run syndication.

- The Fox Network will offer three nights of prime time programming in the Fall, comprising 8-1/2 hours or 36% of a typical network 22 hour prime time schedule. Fox has announced plans to go to five nights/week in the next 18 months. Its program suppliers will include Stephen J. Cannell ("21 Jump Street"; "Booker"), Columbia ("Married With Children") and Paramount ("Open House"), all of which also supply prime time programs to NBC, CBS or ABC. For 1988-89, with only two nights of programming (5-1/2 hours), Fox's program expenditures were estimated at $100 million.

These are all clearly "'prime time' type" programs, regardless of what distribution medium is used or what time of day they are scheduled. More important to the issue of competition in program acquisition, the potential purchasers of these programs certainly have the resources to compete against any of the three networks on price or contract terms, which are the key elements of any program deal. NBC, CBS and ABC are not competing against small or economically weak buyers that cannot match a network's offer to program creators. Rupert Murdoch's News Corporation owns the Fox Network, Time Warner owns HBO, Viacom owns Showtime, Paramount and MCA own USA. These large conglomerates are certainly formidable competitors for the kind of creative talent, programs and sports events that might appear on network prime time television.

In fact, the dollars spent by the networks and all these other broadcast and cable outlets are essentially chasing after the same creative talent and premiere events -- the writer/producers who have a proven track record of success and the major sports events that attract audiences. Whether a cable network spends exactly the same dollars per hour as a broadcast network, or whether it schedules an original program in the network prime time period, it is competing with each of the three networks and all the other programming channels for the same talent and product.

Question: Has the amount of revenues the networks receive from advertisers increased in the past few years?

Response: While network revenues have grown overall over the past five years, that growth has been minimal and has been nowhere near the growth enjoyed by broadcast television advertising generally or cable advertising in particular. In fact, between 1984 and 1988 -- a period that includes a strong Olympic sales year -- the compound annual growth rate for network ad revenues was only 2.2%, while total television advertising grew at 6.9% and cable advertising at a hefty 26.6%. Since the inflation rate during this period was 3.3% per year, network advertising revenues actually have declined in real dollar terms since 1984.

According to Arthur Young data, which is a compilation of submissions by each of the three networks, the growth in net network ad revenues has slowed considerably in the past several years. In 1984, bouyed by the Summer and Winter Olympics, network revenues climbed to over $6.6 Billion, a 20% increase over 1983. But in 1985, three-network revenues declined for the first time in a decade, down 3% to about $6.4 Billion. Between 1984 and 1985, total TV advertising growth was also less vigorous, but still grew at a rate of 5%. Thus networks were particularly hard hit. In contrast, cable advertising revenues rose 37% year to year.

In 1986, network revenues recovered to only $6.7 Billion, an increase of 3% over 1985. Total TV advertising grew 8.5%, again outpacing networks, and cable ad revenues rose 18%.

Ad sales growth was even more sluggish in 1987 at 2% for all three networks, with total net revenues reaching about $6.8 Billion. Overall TV advertising rose 5% that year, but cable again experienced a healthy increase of 21%.

The three-network market was somewhat stronger in 1988, when growth was at 8% as compared to overall TV ad revenue growth of 9%. But, as in 1984, a lot of that increase was attributable to higher advertiser spending in Olympics programming as opposed to underlying market growth. Cable advertising growth again surpassed all forms of broadcasting at 31%.

In June of this year, the networks began their "up front" selling season for a certain percentage of advertising inventory for the 1989-90 broadcast year. Sales were strong in this year's up front market, with increases in both the amount and price of network inventory purchased. However, the jury is still out on whether this early strength will mean large year to year revenue or profit increases for any of the networks. Such increases will depend on both ratings performance and the so-called "scatter market" where the remaining inventory will be sold.

Network advertisers are guaranteed a certain delivered audience when they buy in the up front market. If a network's ratings fall short of that promised audience delivery, then the network "makes good" the promise using unsold inventory that would otherwise be purchased in the scatter market. Thus a network that under-performs will have less inventory to sell for the balance of the season. Moreover, even for a network with inventory to sell, if pricing in the scatter market turns out to be weak, the strength of its up front sales may be dissipated and its total sales revenue picture may be bleak. In short, the strong up front market is not necessarily a sign that 1989 will be a good revenue growth year for the networks.

Question: If the networks are permitted to own cable systems, what will prevent the networks from creating the two tier system you discussed: one tier of high quality programming on cable and another tier of lower quality for over-the-air television?

Response: The quality of cable and broadcast programming will be driven by the economic incentives those respective program services have to provide the kinds and quality of service sought by their audience. In both the broadcast and cable media there are too many actual and potential competitive program suppliers for any entrepreneur to stifle or twist competition in a manner contrary to the marketplace.

A broadcast network would not arbitrarily reduce the quality of its broadcast service for the purpose of favoring the cable systems it owned because it would harm its network and station businesses without benefitting its cable system business. For example:

1) Its broadcast network would not be able to compete with other existing broadcast and cable networks and would quickly suffer economic harm;

2) the network's owned stations would suffer serious audience erosion and would become less profitable and less valuable; and

3) new broadcast networks, like the expanding Fox Network, would replace it. Affiliates, advertisers and audience would turn to those more attractive broadcast network competitors to the further detriment of the network and its owned stations.

Moreover, this hypothetical two-tier strategy might not even help the network's cable business. The audience which no longer tuned in the broadcast network would not necessarily become subscribers to the cable systems owned by that network. In the first place, the network is unlikely to own cable systems serving more than a small percentage of total U.S. cable subscribers. By disadvantaging its national broadcast service, the network would have the potential of gaining subscribers only on that small percentage of systems.

Secondly, most of the viewers in the areas in which the network did own cable systems would not automatically subscribe to cable or watch cable-originated programming if they did. Many of these viewers would turn to other broadcast networks and stations both received over-the-air and carried by the cable system, including those which might be stimulated to fill the gap created by that network's abandonment of quality service. And many of these viewers might not be able to afford cable service, might not be within a cable service area, or might not choose to become cable subscribers as a matter of principle.

Thus, the loss to the broadcast network from such a deliberate policy would be substantially greater than any potential gain to its owned cable systems. The audience simply has too many other broadcast and non-broadcast choices to make this an effective, economic or even rational strategy.

Broadcast networks will always have the incentive to present the most attractive programs the economics of broadcast networking permit, regardless of whether they also own cable systems or cable networks. The real problem, as we have explained to the Subcommittee, is that outmoded government regulations have artificially diminished the economic incentive of the broadcast networks to compete for and invest in quality programming by limiting their ability to receive financial returns for its non-network use. This confines the economic return on their investment in programs only to those advertising revenues generated by two broadcasts of each program episode. Were broadcast networks also able to share in the revenues and profits from other uses of these programs, they would have the incentive to invest more money in program development, acquisition and production, thereby increasing the quality of the programs and the enjoyment of the public, as well as the value of the programs during network exhibition and in other subsequent markets.

Question: Fox Broadcasting is proposing to establish a cooperative for its children's programming. Do you believe that the cooperative's programming should be included in determining whether Fox is a "network"?

Response: In NBC's view, it is clear that the "Kid's Network" will be run, managed and controlled by Fox, and should be included in the number of hours of program service offered by Fox for the purpose of determining whether Fox is a "network" as defined by Section 73.658(j) of the Commission's rules.

NBC's knowledge of the so called "Kid's Network" comes from the news reports of information released by Fox. Attached hereto for your information are reports from the New York Times (June 15, 1989) and Broadcasting (June 12 & 19, 1989). That Fox should have to go to the lengths described in these articles just in order to be able to argue that the Kid's Network should not be counted in the Fox Network's service underscores how outmoded and detrimental many of these rules are in today's environment. The rules put those entities affected under such a competitive disadvantage that it is well worth Fox's attempt to avoid their applicability to its network operations. However, it does not appear to NBC that those efforts successfully distinguish the Kid's Network hours from those already offered by the Fox Network to its affiliates.

According to the attached reports, Fox has developed the programs, developed the format, organized the schedule, and, in the words of one report, the on-air package will be "financed, managed, promoted and sold by Fox". Fox made the proposal to its affiliate board, and the Kid's Network ownership structure has been referred to as a "device" by a Fox affiliate board member. The president of Fox "is searching for an executive to run Kid's Network", one report said.

Two of the six minutes of advertising time in each half hour will belong to Fox, to "repay" Fox for financing the Network. Fox is also to receive "management fees and sales commissions" for its part in "running" the network.

Even any money which may remain after making these various payments will be subject to sharing by Fox, whose owned stations will also share based on audience delivery. Since the Fox stations serve such a large percentage of the homes of the total Fox Network, Fox's share of this remainder will be substantial.

In these circumstances, to allow Fox to escape from the application of the FCC's network rules would be plainly unfair to other network competitors and to the affiliates of those networks. Similarly, to accept the argument advanced in Fox's testimony before the Subcommittee that its Network should be entirely exempt from these rules would give a formidable competitor to NBC, CBS and ABC unwarranted and unfair economic advantages.

Fox competes with NBC, ABC and CBS in all aspects of networking -- for viewers, for affiliates, for programs, and for advertisers. Rules imposed only on the older networks adversely impact not only them but the program suppliers and advertisers with whom they deal -- and, perhaps most importantly, the stations affiliated with them. It is for this reason that NBC's affiliates have urged that the Commission

> assure that its rules and regulations, whatever their form, be uniformly applied to all networks and their affiliates . . . This is the equitable and only way to assure that in their local markets affiliates of each of the several networks are able to compete on fair and equal terms.

Resolution of the NBC Affiliates Board of Directors dated June 17, 1988.

Today, Fox is not a struggling enterprise entitled to some special dispensation. A few facts will demonstrate how quickly Fox has become a major player in the national television program distribution marketplace:

- Fox affiliates cover 89% of the nation's television homes. While Fox's arguments for relief rely heavily on the fact that most of these affiliates are UHF stations, they neglect to point out that cable carriage has significantly reduced any technological disadvantage UHF may have historically suffered.

- Fox is producing and licensing programming for its network that is comparable to the older networks' programming in virtually all respects -- including program types, suppliers, and prices.

- Fox has been wooing traditional network advertisers with very substantial success.

- Many Fox programs have been successful in attracting viewers, particularly its Sunday night schedule, where it recently beat all three networks from 8-9 PM. Fox is particularly popular among the young viewers that are most attractive to advertisers.

Clearly, then, Fox is hardly "emerging" -- it is already a vigorous competitor in the national programming marketplace. Certainly there is no doubt as to the huge financial resources available to Fox to finance its competitive efforts. Fox is a major Hollywood studio with huge assets, which is engaged in all aspects of the television programming business: production, syndicated distribution, station ownership, and now also networking. Fox is also part of a still larger conglomerate -- News Corporation -- with interests in virtually every phase of electronic and print communications. Fox's inroads into networking are substantial and highly competitive with the traditional networks, each of which suffers from the restraints of current network regulations. There is absolutely no rational basis artificially to bias the marketplace by providing Fox and its affiliates with economic advantages over their competitors.

At such time as the programs offered by Fox to its affiliates -- including the programs of the Kid's Network -- reach a total of 15 hours per week, the rules of the Federal Communications Commission concerning networks should in our view also apply to Fox and its affiliates. If Fox is exempted from these rules notwithstanding that it meets all the rules' definitional criteria, then all networks -- old and new -- should be exempted. Better yet, as we have urged, the Financial Interest and Syndication Rules should be repealed, allowing a freer more competitive marketplace to prevail.

Question: Do you believe that the Commission should retain its policies designed to promote minority ownership?

Response: NBC has been a longtime supporter of increased minority ownership of broadcast stations. For example, NBC provided substantial funds and guarantee commitments which made possible the establishment of the Broadcast Capital Fund (BROADCAP), which has been the broadcast industry's vehicle for providing a significant number of minorities with the financial ability to purchase broadcast stations. And when NBC recently sold its highly successful Washington, D.C., FM station, WKYS, we sold it to a minority purchaser with especially favorable financing arrangements without which the purchase would not have been possible. The NBC Television Network also has affiliated with minority-owned stations.

While NBC does favor increased minority ownership and has itself taken action to increase minority ownership where it has had the ability to further such a result, NBC does not have a position with respect to the specific policies adopted by the Federal Communications Commission to promote minority ownership, and whether these particular policies are appropriate to achieve that goal.

Question: Your companies are now permitted to own 12 TV, 12 AM and 12 FM stations. Are any of you seeking to buy more stations? What are the efficiencies of owning stations throughout the U.S.?

Response: NBC currently owns seven television stations covering 22.4% of U.S. TV households. We recently completed the sale of all NBC Radio Stations. While NBC is not at this time actively seeking to purchase additional television stations, we have an ongoing general interest in expanding our station portfolio to the legal limit if there are opportunities in key markets at purchase prices that make business and economic sense.

NBC is a programming company and has historically found it valuable to own some of the stations over which that programming is carried. But, more importantly, television stations are good stand-alone businesses, and the profits from NBC's stations have often provided a stable flow of dollars to the company when the economic fortunes of the network were dim. Unlike other owners of major market affiliated stations, the profits generated by NBC's owned stations, in good times and bad, help to support a national network whose entertainment, news and sports programs are distributed without cost to hundreds of local affiliates and every TV home across the country.

Owning stations also brings NBC in closer touch with the needs and desires of our affiliates and the public interest responsibilities they must serve.

NBC has found that both in terms of our skill as a station operator and in terms of the optimal distribution base for the network it is preferable for our company to own stations in major markets. Therefore any future acquisitions are likely to be in the Top 20 markets rather than smaller communities.

Question: Do any of your companies own 2 broadcasting stations in the same market? If so, do those stations carry more news and public affairs programming than a single station that you own in another market?

Response: Since the sale of its Radio Division, NBC does not operate more than one broadcast station in the same market.

QUESTIONS OF SENATOR EXON AND THE ANSWERS THERETO

Question: What significance is there in the Time/Warner/Paramount situation for the financial interest debate?

Response: The Time/Warner merger has created one of the largest media and entertainment companies in the world. The corporate maneuvering and escalating values that characterized the Time/Warner/Paramount battle were in recognition of the fundamental and rapid changes occurring in the video industry -- changes that require vertical integration to exploit the synergies of producing programs, creating program services and distributing programs to all media; that require leadership positioning in every key market and segment of the industry; and require a global presence to compete against international media giants.

Executives of the three companies that were embroiled in the Time Warner fight all justified their desire to grow by merger or acquisition by citing the need for the resources to compete in a world of vertically integrated media conglomerates. They argued that to be successful in this environment, it will be critical for a media company to have a leading and integrated role in all key markets and to be positioned to take advantage of global opportunities. NBC agrees with this philosophy, but, paradoxically, finds itself precluded from similar opportunities in the new world of vertically integrated media conglomerates. Anachronistic regulations -- The Financial Interest and Syndication Rules -- limit NBC's ability to compete against its unconstrained rivals in both the domestic and international marketplace.

The fully integrated media company that emerges from the Time Warner deal will have tremendous competitive advantages. It will be able to combine domestic and international production and distribution. It will be able to respond to consumer demand through a variety of distribution outlets.

Warner's high risk production business will have access to HBO, Cinemax, Turner Broadcasting's cable services and 5.5 million cable homes. The revenue generated by these cable program channels will, in turn, fund more production for both the cable channels and the lucrative broadcast syndication distribution business. The Time Warner distribution system, which includes theaters, cable systems, national and international syndication arms and home video sales, will provide a stable distribution and revenue base for existing and new program production and program services. Warner's international presence will enable the new entity to market HBO and other program services abroad.

This new company, which will be a major end-to-end participant in every aspect of the media and entertainment business throughout the world, will be positioned to deal with global competition. And it will be able to participate in any phase of the media business on a marketplace basis.

In contrast, NBC, CBS and ABC are disadvantaged as producers, as programmers and as distributors by antiquated economic regulation. In the world, only NBC, CBS and ABC cannot participate fully in each segment of the business. Only these three networks lack the incentive to invest in program production and are limited in their ability to bid for new product and enhance existing product because they cannot participate in syndication revenues. Only these three networks cannot fully participate in all distribution outlets. The networks alone are prohibited from acquiring the foreign syndication rights to others' programs.

If we examine some of the competitive strengths and opportunities the new Time Warner combination will enjoy, and also describe how the free broadcast networks are foreclosed from participating in many of the markets in which Time Warner will operate, we can illustrate how NBC is disadvantaged by the rules in its ability to compete and participate in the domestic and international media market.

- In production Time Warner will be the largest supplier of video product in the world. Warner Brothers/Lorimar Telepictures is a major theatrical motion picture studio. In addition, last season Warner/Lorimar supplied the greatest number of prime time entertainment programs of any studio to the three television networks -- 15 in all -- including "Night Court," "Growing Pains," "Head of the Class," "Perfect Strangers," "The Hogan Family," "Murphy Brown," "Full House," "China Beach," "Dallas," "Knots Landing," and "Falcon Crest." Warner/Lorimar is also a major producer of original product for television stations (first-run syndication), including "She's the Sheriff," "Superior Court" and "Love Connection."

Warner also provides financing for the programs of independent producers, such as Alien Productions for "Alf". Warner finances the production, provides facilities and retains a percentage of the revenues generated through network license fees, syndication and other sales. Time Warner's HBO is also a major financier, but of theatrical movies, both for its pay cable movie service and for theatrical release. It finances films produced by many of the major studio and independent producers, often receiving not only distribution rights on HBO and/or Cinemax but a share of the profits from the film. Thus, Time Warner may finance all types of video product without any restrictions on its ownership participation or its share of the revenues or profits from the exploitation of the product in all distribution media.

- The Time Warner competitive position contrasts with that of the broadcast networks. For the networks, the economic viability of producing for either the network or first-run syndication is undermined by the FCC's prohibition against sharing in the revenues or profits from the business of syndicating programs directly to U.S. TV stations. Networks must sell these distribution rights off to third parties on a non-marketplace basis, usually receiving less than they would as profit participants. Domestic and international syndication is a stable and lucrative element of the production business that can provide a revenue stream that offsets production deficits, and generates funding for new production efforts and substantial profits in even moderate success.

Of equal importance, the networks cannot -- like Warner does with "Alf" -- finance the programs of other producers and retain some ownership position. This disadvantages NBC not only as a producer, but as a network programmer, because it severely limits our ability to competitively bid for product against HBO, the Fox Network, basic cable, and other distribution outlets that can risk a larger upfront investment in programming in the hopes of a return in the syndication market.

- Distribution may be the most significant competitive advantage of the Time Warner merger. The combined company will be the nation's second largest cable operator, with 5.5 million subscribers (about 12% of the total). These cable systems provide a guaranteed base of distribution for Time Warner's existing cable services and any new services they may wish to launch.

Warner/Lorimar owns a major syndication business, which distributes theatrical, first-run and off-network product in the U.S. and abroad. Warner's value as a company is substantially derived from the current and prospective cash flow from syndicating its library of theatrical and television product, and the many programs currently on the three networks' prime time schedules, to television outlets around the world. "Growing Pains" alone is projected to command more than $100 million in syndication revenues in 1989. A new Warner/Lorimar program will go into off-network syndication each year for the next several years.

Warner is particularly strong in its international syndication business, which accounted for 40% of its revenues last year. Warner not only sells its own product abroad, but has acquired the rights to market the movies produced by the Disney studio.

- Networks' inability to participate in domestic syndication or to share in the revenues or profits from that activity reduces their incentive to invest in programs produced by others or to serve as source of original product for the network or TV stations. As already noted, this prohibition limits their ability to bid against unrestricted media for programs. Their incentive to put more money "on the screen" for programs already scheduled is similarly reduced by the limited economic returns possible from advertising revenue alone.

The restrictions the rules impose on networks' international activities are particularly egregious and unfair. In an era of burgeoning foreign media markets and foreign investment in U.S. studios, the networks cannot do in foreign countries what foreigners can do here or what domestic competitors (like Time Warner's international syndication arm and its pay cable network, HBO) are doing around the world. Networks cannot syndicate others' programs abroad or co-produce programs in the U.S. with foreign investors' money. We cannot do what Warner has done with Disney and acquire the foreign syndication rights to theatrical movies if those movies have ever appeared on television. We do not have the freedom to invest in foreign co-productions the way foreigners can invest in American co-productions. Networks cannot become full participants in the global media marketplace because of regulations that were adopted when this marketplace hardly existed.

By burdening the three traditional over-the-air networks with domestic and foreign competitive restrictions, the rules strike at the very heart of the American television system -- the networks' universal, free national service upon which so many local stations and viewers rely. Antiquated economic regulations should not shackle the free system's ability to participate in the changing world, while companies like Time, Warner or Paramount -- individually or as a newly-merged entity -- can proceed without restriction to produce and invest in programming, distribute through every type of media outlet, and form strategic, global businesses and alliances for the future. These rules, which reflect a 1960's world, neither benefit our nation's viewers nor enhance America's overall competitiveness as we move into the 1990's.

Senator INOUYE. Thank you very much, Mr. Wright.
Mr. Murphy.

STATEMENT OF THOMAS S. MURPHY, CHAIRMAN AND CEO, CAPITAL CITIES/ABC, INC.

Mr. MURPHY. Mr. Chairman, my name is Thomas Murphy. I am the President and Chief Executive Officer of Capital Cities/ABC. I appreciate the opportunity to testify before you on the issue of media concentration and diversity.

With your permission, I will summarize my statement and submit the complete version for the record.

Senator INOUYE. You may do so, sir.

Mr. MURPHY. Let me begin by defining what we do. The ABC television network and its two major network competitors are the only entities that provide a full schedule, diverse national programming service. The unique value of network news in bringing coverage and analysis of important events into every home is, I believe, widely recognized. The same is true of the special contribution which network sports coverage makes to the entertainment of millions of Americans.

But our service is not, of course, limited to news and sports. The ABC television network offers to its more than 200 affiliated stations for roughly 12 hours each day a mixed schedule of entertainment, sports, and news programming. Each of our affiliates melds the national service provided by the network into an overall schedule containing local news, local sports, and other locally selected or produced programs. The mixture of a nationally produced and distributed service, together with local control, is uniquely American and, I suggest, uniquely successful.

We hope and believe that what our audience receives is, taken as a whole, a service of irreplaceable value. That service is highly desirable, not only to those who watch our network and our affiliates over the air; but studies have shown that even in the more than 50 percent of homes having cable television and the wide range of choices cable provides, the majority of viewing hours is devoted to the programs of the three national networks and their affiliates. And many independent, nonaffiliated stations, as well as a number of cable program services, rely heavily on reruns of programs that were originally produced for broadcast by one of the three national networks.

Because what we broadcast is a staple of much of the television in the United States, the continued health of the network system is, and should be, a matter of public interest and concern. Today, the health of that system is in jeopardy.

Network and local over-the-air entertainment program is financed virtually exclusively from the revenue produced by advertising. Advertising revenue is largely a function of audience size, and even though network programming is a staple of all media, our audiences have diminished significantly.

The three networks' combined share of the prime time audience has declined from more than 90 percent in 1970 to approximately 67 percent in the season just past. While advertising demand can vary annually, depending on business cycles and other factors, this change in the size of the audience is not cyclical. We have experienced a permanent structural change in the media market, and the audience will not be recaptured. That is because the last decade has seen the emergence and growth of major new distribution outlets, both over the air and cable, and a proliferation of viewing choices for the audience. Today, the networks face tougher and still growing competition for audience and advertising dollars from independent stations, the growing Fox network, cable program services, and other new media.

The statistics have been widely reported, and I will not repeat them here except to note that just in the past five years the number of channels received by the American television household has increased from 10 to 27. The reduced audience levels we live with inevitably act as a kind of cap on what advertisers will pay for the time on the network. But while there is a cap on revenues, there is no cap on the rapidly escalating costs we must pay for the kind of programs that the national audience has grown to expect from the three networks.

I want to stress that I am not here predicting the demise of the networks, or asking that Congress find a way to assure network profitability. We are prepared to compete with all of the new media and to make whatever investments may be necessary to protect the quality of what we do. But existing and, in our judgment, outmoded rules and regulatory restraints make that competition far more difficult than it needs to be or should be, by inhibiting us from making the kind of investments in programs that all other media entities can make.

In a fully competitive program market, the networks would be allowed to pay more for the programming they license in exchange for rights to share in the non-network broadcast value of these programs, particularly in the profits from the sale of programs directly to television stations or to cable in the so-called syndication market. Without that opportunity and so long as we are limited to one revenue stream, there is likely to be an ever increasing gap between what those who produce programming insist on charging and what we can afford to pay for programs. Ultimately, the quality of those programs may suffer, a result that would be harmful to us, to our affiliates, and to the American public.

The three national networks are also restricted in another way: in the number of hours of prime time entertainment programs we can produce ourselves. The expiration of these so-called production caps in November 1990 will permit Capital Cities/ABC to create its own production capacity so that we, like the major Hollywood producers, can develop our own talent, control our own costs, and increase our chances of finding and benefitting from successful programs.

This is not to say that when the limit of in-house production expires we would produce all or most of our own programming. But I believe that the networks must be free to develop their own programming if they are to maintain the quality that is the backbone of this Nation's broadcast and cable system.

At the direction of Congress, we have been involved for several years in negotiating with the Hollywood production community, which has been largely opposed to any changes in these rules, to see if we can compromise our differences. We are hopeful that we will be able to make more progress in these negotiations in the future than we have been up until now. In our judgment, a resolution of the issues will only come when both sides agree that the problems that I have discussed are real, and that the capacity of the existing system to fund a steady supply of high quality programs is imperiled.

I realize that there are those, particularly in the Hollywood community, who argue that the networks should not be freed from the restraints upon them, that they would abuse that freedom by coercing unwilling producers to giving away interest to their programs as the price for obtaining a slot on the network schedule. Given the large number of choices available to the Nation's viewers, it is, I suggest, naive to believe that any network would make program decisions on any basis other than what is most likely to attract the largest audiences. And given the size of the major program producers today and the options available to them, it is equally naive to believe that any network could force them to enter into program transactions against their will. I do not believe that in the real world we are a threat to the economic independence of Warner, Paramount, Disney, or Twentieth Century Fox.

All that we seek in the program area is an opportunity to compete fully. If the playing field were level and we were permitted to compete, we would have no problem with the fact that the studios, who are our suppliers, also compete with us as program syndicators, cable programmers, and cable system and television station owners, nor would we be troubled by the efforts of Fox to develop a fourth national network, one, I might add, that is currently unfettered by most of the key restrictions imposed upon us. Indeed, we see the same need to grow as those companies do in order to be more effective in competing against other large media companies, both home and abroad. We think, as well, that there is every reason for the networks to be free to participate fully in other media businesses which are aligned to the network business. In my complete testimony I discuss in particular why prohibitions on the networks' participation in the cable ownership business and foreign syndication business should be eliminated.

In sum, as I look at to the future, I see a continuation of current trends in the network business: aggressive competition among the networks and between the networks and other media for audiences. That competition can only benefit the American public, which will continue to enjoy a panorama of program choices. In order for us to compete effectively, I believe that the network companies must be freed from many of the restrictions that inhibit our ability to be full players in the burgeoning domestic and global programming industry. Speaking for Capital Cities/ABC, I can say that our overall goal is to continue to offer the diverse, high quality network program service of news, sports and entertainment which, in combination with our affiliates' programming, has been the hallmark of the Nation's over-the-air television system.

Thank you, Mr. Chairman.

[The statement and questions and answers follow:]

STATEMENT OF THOMAS S. MURPHY, CHAIRMAN AND CEO, CAPITAL CITIES/ABC, INC.

Mr. Chairman, my name is Thomas S. Murphy, and I am Chairman and Chief Executive Officer of Capital Cities/ABC, Inc. I appreciate the invitation to testify before you on the subject of media concentration and diversity. I would like today to accept your specific invitation to discuss how the elimination of some existing restrictions might improve the delivery of programming to the American public. We strongly believe that several aspects of the regulatory structure constitute a threat to our long-term ability to meet the needs of our audience in the most efficient way. We also believe that the removal or modification of those restrictions would enhance the nation's over-the-air broadcast system, a system that plays a vital role as a source of information, entertainment and culture in the lives of the American people.

Let me begin by defining what we do. The ABC Television Network and its two major network competitors are the only entities that provide a full-schedule, diverse national programming service. The unique value of network news in bringing coverage and analysis of important events into every home is, I believe, widely recognized. The same is true of the special contribution which network sports coverage makes to the entertainment of millions of Americans. But our service is not, of course, limited to news and sports. The ABC Television Network offers to its more than 200 affiliated stations, roughly 12 hours each day, a mixed schedule of entertainment, sports and news programming. Each of our affiliates melds the national service provided by the network into an overall schedule containing local news, local sports, and other locally selected or produced programs. The mixture of a nationally produced and distributed service together with local control is uniquely American and, I suggest, uniquely successful. We hope and believe that what our audiences receive is, taken as a whole, a service of irreplaceable value.

That service is highly desirable not only to those who watch our network and our affiliates over-the-air. Studies have shown that, even in the more than 50% of homes having cable television and the wide range of choices cable provides, a majority of viewing hours is devoted to the programs of the three national networks and their affiliates. And many independent, non-affiliated stations, as well as a number of cable program services, rely heavily on reruns of programs that were originally produced for broadcast by one of the three national networks.

Because what we broadcast is the staple of much of the television viewing in the United States, the continued health of the network system is and should be a matter of public interest and concern. Today, the health of that system is in jeopardy.

Network and local over-the-air entertainment programming is financed virtually exclusively from the revenue produced by advertising. That single revenue stream means that our viewers pay nothing extra for our unique advertiser-supported service. It also means, unfortunately, that our source of revenue is vulnerable -- dependent on the strength of the advertising marketplace, which varies from year to year, and the perceptions of advertisers that the networks and stations will deliver the audiences they want to reach.

I want to focus today on network television, a business that is more risky now than it has ever been before. Last year, Capital Cities/ABC committed approximately $1 billion to provide entertainment programming for our audiences and approximately another $1 billion on news and sports. And it made that commitment before a single dime of advertising had been committed to the network. That's a big bet, and one that has not proven to be a particularly good one for us. In the three years since Capital Cities merged with the American Broadcasting Companies, the network -- viewed as an independent enterprise and with required accounting overlays eliminated -- has simply broken even.

Advertising revenue is, as I have suggested, ultimately a function of audience size. And even though network programming is a staple of all media, our audiences have diminished significantly. The three networks' combined share of the prime time audience has declined from more than 90 percent in 1970 to approximately 67% in the season just past. While advertising demand can vary annually, depending on business cycles and other factors, this change in the size of the audience is not cyclical. We have experienced a permanent, structural change in the media market, and the audience will not be recaptured.

That is because the last decade has seen the emergence and growth of major new distribution outlets -- both over-the-air and on cable -- and a proliferation of viewing choices for the audience. Today, the networks face tougher and still growing competition for audiences and advertising dollars -- from independent stations, the growing Fox network, cable program services and other media. Between 1983 and 1988, for example, the number of independent, non-affiliated television stations has more than doubled (from 179 to 381); the number of households subscribing to cable systems has increased from 28 million to almost 50 million; and the number of channels received by the average television household has increased from 10 to 27.

The reduced audience levels we live with inevitably act as a kind of cap on what advertisers will pay for time on the network. While in 1980 even the weakest network could offer advertisers an attractive vehicle for their messages, today it is far more difficult to attract advertisers to the programs with smaller audiences. But, while there is a cap on revenues, there is no cap on the rapidly escalating costs we must pay for the kinds of programs that the national audience has grown to expect from the three networks.

I want to stress that I am not here predicting the demise of the networks, or asking that Congress find a way to assure network profitability. We are prepared to compete with all of the new media and to make whatever investment may be necessary to protect the quality of what we do. But existing, and in our judgment outmoded, rules and regulatory restraints make that competition far more difficult than it needs to be or should be -- by inhibiting us from making the kinds of investments in programs that all other media entities can make. Simply put, these restraints -- adopted in a different time, when the networks were virtually the only source for national programs -- prevent the three networks, and only the three networks, from opening up new revenue streams by negotiating flexible funding relationships with those who provide us with entertainment programs.

In a fully competitive programming market, the networks would be allowed to pay more for the programming they license in exchange for rights to share in the non-network broadcast value of those programs -- particularly in the profits from the sale of programs directly to television stations or to cable in the so-called syndication market. That form of funding is typical in most media-related industries. Book publishers, for example, can and do pay authors more when the publisher acquires the right to share in revenues that a best-seller may earn if it is used as the basis for a movie or television show. Movie distributors pay movie producers more when the distributor acquires the right to share in revenues the picture may earn in television. And the major studios do precisely the same thing when they buy the after-market rights to the television programs that they license to the networks or distribute for first-run syndication. The networks alone are prevented from buying in the free market, from producers who want to sell, rights to share in the non-network value of the "hits" for which the networks already pay the bulk of the production cost.

Without that opportunity -- and so long as we are limited to one revenue stream -- there is likely to be an ever-increasing gap between what those who produce programming insist on charging and what we can afford to pay for programs. Ultimately, the quality of those programs may suffer -- a result that will be harmful to us, to our affiliates, and to the American public.

I might add that sharing a higher percentage of the costs in exchange for an opportunity to participate in the so-called back-end revenue of a program is no guarantee of success. Most programs are not sufficiently successful to have potential in the syndication market. But that is precisely the kind of risk that the major studios and independent program producers take every day, and we believe that is no reason to deny the networks the same opportunities for risk and success.

The same set of restraints has, over the past decade, inhibited the three networks -- alone among media companies -- from producing programs themselves. We are, for example, currently prevented by those restrictions from producing for broadcast more than five hours per week of entertainment programs in prime time. That five-hour restriction will disappear from the law in November, 1990, and the expiration comes none too soon.

The elimination of the restriction will permit Capital Cities/ABC to create its own production capacity so that we -- like the major Hollywood producers -- can develop our own talent, control our own costs, and increase our chances of finding (and benefiting from) successful programs. This is not to say that when the limit on in-house production expires, we would produce all or most of our own programming. But I believe that the networks must be free to develop their own programming if they are to maintain the quality that is the backbone of this nation's broadcast and cable system.

At the direction of Congress, we have been involved for several years in negotiations with the Hollywood production community -- which has been largely opposed to any changes in these rules -- to see if we can compromise our differences. We are hopeful that we will be able to make more progress in these negotiations in the future than we have up to now, but a resolution of the issues will only come when both sides agree that the problems I have discussed are real, and that the capacity of the existing system to fund a steady supply of high quality programs is imperilled. For now, the producers appear to believe that it is in their interest to keep the networks out of production and away from traditional funding techniques -- leaving the Hollywood studios as the major source for entertainment programming development and distribution. The producers' desire to avoid competition may be understandable. But it is not a basis on which important public policy should be built.

I realize that there are those, particularly in the Hollywood community, who argue that the networks should not be freed from the restraints upon them -- that they would abuse that freedom by coercing unwilling producers into giving away interests in their programs as the price for obtaining a slot on the network schedules. This "network power" argument led the FCC in 1970 to impose the restraints on the networks that are embodied in the existing rules. Whatever the merits of that argument in 1970 -- and we do not believe the rules were necessary even then -- by 1983 (on the basis of studies it initiated in the 1970's), the FCC concluded that the program marketplace no longer required -- indeed was hurt by -- those rules. The Commission found that elimination of the rules would enhance, not reduce, competition and diversity in the development and supply of entertainment programming. It relied for this conclusion on trends in the growth in the competitive marketplace which, by today, have become a reality.

To those who would argue that the networks should continue to be regulated because the three of us still reach 60% to 65% of the prime time audience, I would suggest that there is no such entity as the "three networks with a 65% share of the prime time audience." There are three separate, vigorously competitive and highly aggressive entities which reach consistently smaller audiences, and which face dramatically stronger competition.

ABC learned that lesson the hard way, after it passed on the opportunity to broadcast The Cosby Show, only to see the program become the bedrock of NBC's revived and powerful prime time schedule. By the same token, we obtained the number-one rated Roseanne after it was passed over by one of our competitors. And our critically acclaimed series, The Wonder Years, is on ABC because its producers were so confident that one of the three networks would take the program that they offered us take-it-or-leave-it terms -- and we were smart enough to take it. If our critics were correct about some kind of three-network monolith, none of these shows might have reached the audience.

In any discussion of network dominance, it is worth considering that NBC -- currently the most successful network -- closed the past season with an average prime time audience comprising only 16% of total TV homes and 26% of the households viewing any television. Notwithstanding NBC's success, those numbers mean that 84% of the total TV homes in the nation and 74% of the households viewing television were not watching NBC during an average quarter-hour of prime time.

In short, the large number of choices available to the nation's viewers requires us to compete vigorously and aggressively by offering those programs that are likely to attract the largest audiences. It is, I suggest, naive to believe that any network would make program decisions on any other basis -- or that given the size of, and options available to, program producers today, any network could force them to enter into a program transaction against their will. I do not believe that, in the real world, we are a threat to the economic independence of Warner, Paramount, Disney or Twentieth Century Fox.

Again, I welcome the competition that the new order requires. Competition keeps companies efficient and innovative. All that we seek in the program acquisition area is an opportunity to compete fully. If the playing field were level and we were permitted to compete, we would have no problem with the fact that the studios who are our suppliers also compete with us as program syndicators, cable programmers, and cable system and television station owners.

Nor would we be troubled by the efforts of Fox to develop a fourth national network -- one, I might add, that is currently unfettered by most of the key restrictions imposed upon us. Indeed, we see the same need as those companies do to grow in order to be more effective in competing against other large media companies, both here and abroad.

We think, as well, that there is every reason for the networks to be free to participate fully in other media businesses which are aligned to the network business -- in particular, cable system ownership and foreign syndication. Network companies alone are prohibited from owning cable systems. None of our competitors in video programming or distribution is so restricted, and the rule is unsound because it bars entry to entities who could be effective and competitive cable operators. In fact, Capital Cities was in the cable ownership business before the merger with ABC required us to divest our systems. We are currently a successful cable programmer, through our 80% ownership of ESPN and our minority investments in the Lifetime and Arts and Entertainment channels. Ownership of cable systems could facilitate our launch of new cable program services. Whether or not that launch occurs, the public would still be better off if existing cable operators were faced with the added competition that networks as cable owners could provide.

Finally, the rules that restrict the networks apply not only to network operations in the United States, but also to syndication abroad. The networks are prohibited from engaging in foreign syndication of any television programs they do not produce. However one analyzes media competition in the United States, we fail to see any reason to put restraints on the networks in foreign markets. Foreign broadcast syndication is a big business -- $1.3 billion in sales in 1988 -- and there is a burgeoning demand abroad for United States product, fueled by the growth in video channels in Europe. Our country's positive trade surplus in video entertainment would be enhanced if the network companies were given the freedom to compete, to open up new markets for American programs. And, I might add, the network companies are part of that very small group that can be reliably expected -- because of the alien ownership restrictions of the Communications Act -- to remain U.S. owned.

In sum, as I look to the future, I see a continuation of current trends in the network business -- aggressive competition among the networks, and between the networks and other media for audiences. That competition can only benefit the American public, which will continue to enjoy a panorama of program choices. In order for us to compete effectively, I believe that the network companies must be freed from many of the restrictions that inhibit our ability to be full players in the burgeoning domestic and global programming industry.

Speaking for Capital Cities/ABC, I can say that our overriding goal is to continue to offer the diverse, high quality network program service of news, sports and entertainment which, in combination with our affiliates' programming, has been the hallmark of the nation's over-the-air television system.

Questions from Senator Inouye

1. We heard that the key to controlling the media marketplace is control over programming. We therefore understand your incentive to have the FCC repeal its financial interest and syndication rules. But, you still have a prime time share of 65% to 70%. Doesn't this indicate you still have market power in the acquisition of programming?

The question is phrased so as to suggest that the three networks are a single entity with a prime time share of 65% to 70% of the audience. In fact, the networks are three independent companies that are fiercely competitive with one another for programming, for audience share and for advertising revenue. For instance, NBC, currently the dominant network in prime time, achieved an audience share (percentage of the homes using television) of only 26% in the 1988-89 television season. Moreover, those homes represent only 16% of total television households in America. It is difficult to see how NBC or either of the other two networks can be said to have market power in light of these facts.

In today's media marketplace, the program seller has a number of viable alternatives to selling to one of the three networks; a producer can offer programs to the Fox network, to independent stations in the first run syndication market, or to the cable programming services for exhibition either on basic cable or pay cable.

The argument is made that, if the networks were permitted to obtain financial interests, they would abuse their role as distributors by favoring those programs for which they were able to negotiate after-market interests. We believe that the vigorous competition among the networks and the large number of other choices available to viewers guarantee that networks will continue to make program decisions on one basis alone -- selecting those programs that are likely to attract the largest audiences.

It has also been hypothesized that, if the programs competing for a hypothetical slot on a network schedule were "equally attractive", the networks would be motivated to favor programs in which they have an interest. We believe the hypothesis is based on a false premise. In fact, programs are never equally attractive. Each program offers different strengths and weaknesses and different prospects for scheduling. The strategy that a network must pursue is to weigh all the variables to create a total program schedule that has maximum appeal in terms of both individual program characteristics and audience flow considerations.

A program that has the potential to succeed will be placed in a network schedule whether or not the network has negotiated for a financial interest in the program. And programs "at the margin" generally do not achieve the level of audience acceptance that would make them viable prospects for after-market success. Accordingly, no network would have the incentive to favor a marginal program in which it has a financial interest over other programs. Generally, only those programs having 66 or more original episodes are likely candidates for success in the non-network exhibition market. Thus, no network would realistically sacrifice its primary interest in maximizing advertising revenue from network exhibition by scheduling an unpopular program over a period of years in the hope that enough episodes would be accumulated so that the program might some day have an opportunity to compete in the syndication market.

2. Who else buys "prime time" type programing? How much?

The Fox Broadcasting Network, first-run syndicators, and cable networks all have an increasing capacity to fund and distribute first-run entertainment programming which can be exhibited during prime time viewing hours.

During the 1988-89 season, the Fox Broadcasting network spent $100 million on 5 1/2 hours of first-run programs distributed to its affiliates on Saturday and Sunday nights (Paul Kagan Associates, Inc. TV Program Investor, November 30, 1988). Fox has announced its intention to increase this investment substantially in the next several years.

The dramatic growth in cable's dual revenue stream means that cable networks have the financial strength to provide alternative outlets for first-run programming. Total cable expenditures on programming have been growing at an annual rate of 16.6 percent since 1983, reaching $2.5 billion in 1988. (See Wilkovsky Gruen Television 1995). One example of this is "The Days and Nights of Molly Dodd", a half hour comedy originally seen on NBC and picked up by the cable network Lifetime when NBC dropped it.

Syndicators are now able to put together ad hoc national networks for first-run programs. One such program, "Star Trek: The Next Generation", was rejected by each of the traditional networks and is now being profitably syndicated to virtually the entire nation (Broadcasting, May 29 1989). As NBC's Chairman, Mr. Robert Wright noted in his testimony before this subcommittee on June 22, 1989, the number of first-run syndicated programs has increased from 45 to 113 in the last five years.

3. Has the amount of revenues the networks receive from advertisers increased in the past few years?

The table on page 9 presents net advertising revenue for the three traditional networks since 1983. These figures do not include the cost of producing commercials and the fees paid to advertising agencies. McCann Erickson publishes an estimate of network revenues which includes both those items since, from the advertiser's point of view, the more inclusive number is a better measure of how much advertisers spend on network advertising. From the network point of view, however, the figures on the table which follows are more pertinent because they represent how much the network actually receives from advertisers.

Both 1984 and 1988 were years in which there were network exhibitions of Olympic events. In addition, in those years national political campaigns generated substantial demand for advertising time. As a result, there was an increase in advertiser revenue in both 1984 and 1988 above and beyond what would have been the case had the Olympics and the political campaign not displaced regular programming and advertising.

Network advertising revenue has grown more slowly than the overall economy and more slowly than total television advertising over this time period. Between 1983 and 1988, network advertising revenue grew at an annual rate of 5.5 percent, while the economy as a whole as measured by Gross National Product increased at an annual rate of 7.4 percent and total television advertising, according to McCann Erickson statistics, grew at an annual rate of 7.9 percent. If actual 1989 network revenue turns out to be at the mid-point of the estimated range ($7.025 billion), then the annual growth rate in network revenue over the 1983-1989 time period will be only 4.0 percent. Based upon McCann Erickson projections, total television advertising (network, and national and local spot) will increase at an estimated annual growth rate of 7.4 percent during the same time period.

In the upfront market this year, the three traditional networks did well. In part this was due to a dramatic increase in demand for advertising time from the automobile companies who are seeking to introduce new product lines and to dispose of excess inventory. It has been reported that automobile companies spent $700 million in the upfront market compared with $500 million last year. This helped to increase prices for remaining advertisers.

There are also some indications that this year's upfront market was fueled by a change in the relationship of advertising and promotions. In the last several years, marketers have increased the amount they spend on promotions, such as price incentives and couponing, relative to advertising. There have been some signs that marketers have become dissatisfied with this tactic and are putting more money back into advertising.

This year's upfront picture does not guarantee an increase in this year's network profits. The networks must deliver the audiences guaranteed in their upfront sales. Moreover, if corporate profits weaken and advertising budgets are reduced, the scatter market could fail to deliver similar revenue increases. Nevertheless, based upon the upfront market the ABC television network expects to make money this year.

Looking beyond the current year, the long-term outlook for network revenue is not necessarily as promising as the current upfront market would indicate. We cannot count on the automobile companies to continue to invest as heavily in the upfront market as they did this year. The apparent movement from promotions back to advertising may not continue.

Most importantly, we remain convinced that the secular decline in network audience share will limit the increases in revenue we can expect from our advertisers. In conjunction with cost increases which we cannot control, this inevitably puts a squeeze on what we can pay for network programming.

The effect of economic growth on network advertising revenues, the choice between advertising and promotion, and the long-term secular decline in our audiences are all crucial determinants of the health of the advertising market that supports our network business. We are not asking Congress to guarantee our profitability by intervening in the marketplace to alter any of these variables so as to increase our advertising revenue. They are part of the risks we take in conducting our business.

We do need help, however, in responding to the long-term structural changes in the network business. These changes mean that we will need to find additional revenue streams outside of the advertising market. We are asking for relief from regulatory impediments that prevent us from opening up additional revenue streams - in particular, a right to negotiate for financial interests in the programs we broadcast and a right to engage in the business of foreign syndication.

Network Advertising Revenue

Year	Network Advertising Revenue ($ billions)
1983	5.567
1984	6.658
1985	6.458
1986	6.681
1987	6.745
1988	7.275
[1989e	6.826-7.255]

Source: Arthur Young, based on information supplied by the three networks accounting departments.

Note: The figures are net revenues, not including the costs of producing commercials and fees paid to advertising agencies. The figure for 1989 is estimated by the ABC Sales Dept.

4. If the networks are permitted to own cable systems, what will prevent the networks from creating the two tier system you discussed: one tier of high quality programming on cable and another tier of lower quality for over-the-air television?

We own many different communications businesses. Our philosophy is to run each business independently according to what is the best strategy for success of each. We do not believe it makes any economic sense to shortchange one business to advantage another. It would make no sense at all to lower the quality of network programming in order to help a cable business that we own.

Moreover, over-the-air networks and cable program services apply very different criteria in the selection of programming. Each must offer quality programming by its own terms of reference in order to succeed. Networks generally offer mass appeal programs that deliver maximum audiences to advertisers. Cable services generally appeal to narrower, specialized audiences. It would make no sense for a company in both over-the-air network and cable program service businesses to reserve the cable tier for high-quality programs and place lower-quality programs over-the-air.

5. Fox Broadcasting is proposing to establish a cooperative for its children's programming. Do you believe that the cooperative's programming should be included in determining whether Fox is a "network"?

For purposes of the financial interest and syndication rules and the prime time access rule, a "network" is defined as any entity "which offers an interconnected program service on a regular basis for 15 or more hours per week to at least 25 affiliated television licensees in 10 or more states." No distinction is made in the definition based on the particular financial arrangements a network may have with its affiliates. Nor is there any provision relating to the type of programming that makes up the 15 hour minimum. Therefore, we believe the Fox cooperative must be counted as part of its network.

We do not believe there is any sound basis on which Fox could be treated differently for regulatory purposes from the three traditional networks. The Fox network is nationwide and competes directly with ABC, CBS, and NBC for prime-time programming, audiences, and station affiliates. It has made significant strides toward achieving parity with the traditional networks in the last several years.

Nevertheless, Fox has argued that it should be exempt from application of the financial interest, syndication and prime time access rules while the other networks continue to be bound by them. There is no basis for granting Fox such a discriminatory exemption. To the extent Fox's argument is based on its belief that the rules are artificial restrictions which are harmful to those engaged in the network broadcasting business, the argument applies equally to the three other networks.

Fox claims that a one-sided application of the financial interest rule is required in order to remain faithful to the underlying purpose of the rule. The purpose of the rule was to enhance competition and diversity in the development and supply of entertainment programming. It was designed to reduce the bargaining power of networks in negotiations with program suppliers. At a 15-hour-per-week program level, Fox would be in the same position vis a vis program suppliers as that which was attributed to the other three networks when the rules were adopted. Indeed, at 15 hours, Fox could offer a full prime time schedule on five out of seven nights of the week. It is our position that no distinction can be made between Fox and the other networks without a general assessment of the purposes of the rule in light of current circumstances.

We believe that the rule has outlived whatever usefulness it ever had, and we would join with Fox in seeking its elimination. Meanwhile, the current industry negotiations on the financial interest rule -- to which Fox is a party through its membership in the Motion Picture Association of America -- are aimed at obtaining at least a compromise modification.

Fox has argued that the technical differences between UHF and VHF stations support a differential application of the rules because a large number of its affiliates operate on the UHF band. However, this technical difference is rapidly being overcome by carriage of local Fox affiliates on cable systems. Over half of all television viewers receive their television from cable, where there is no physical difference between UHF and VHF signals, and the number is growing every day. In addition, despite Fox's UHF differential, its network audience is rapidly increasing. Its ratings for its two nights of prime-time programs increased 39% from the 1987-1988 season to the 1988-89 season. Its programs on Sunday evenings routinely attract audiences larger than those on one or more of the other networks, and they attract the crucial audience group advertisers value so highly: viewers 18 to 49 years old. This fall, Fox is expanding its program service to a third night and is adding a half hour of programming on Sunday nights. (See attached New York Times article, July 17, 1989.)

Fox argues that the discriminatory market structure it discerns in the current network rules is analogous to the special treatment afforded to MCI and Sprint (such as equal access requirements) which were designed to enable them to challenge AT&T in the long-distance telephone market. But those requirements were not regulatory handicaps. AT&T, and later the divested Bell Operating Companies, were required to provide equal access to competitive long-distance companies in order to ensure that the essential bottleneck facilities of the local telephone companies were available to all long distance companies on a non-discriminatory common carrier basis. And this requirement was imposed deliberately as part of a considered judgment that they were needed to promote competition.

In contrast, the discriminatory policy Fox supports is not tailored to any particular monopoly problem. The three traditional networks do not control any facility to which Fox needs access in order to compete. Preventing ABC, CBS and NBC from developing rational supply arrangements with producers does not remedy any bottleneck problem faced by Fox.

Fox is such a large player in the global media marketplace that its claim to merit a regulatory benefit cannot withstand even minimal scrutiny. Fox is a component of News Corporation, Ltd., a global media giant. The parent company has publishing interests in Australia, Great Britain, and the United States, including News of the World and the Sunday Times in Great Britain and newspapers in Boston and San Antonio. The company owns TV Guide, which has a circulation of 17 million, and is the major source of information on what is available on U.S. television. In addition, the company owns the publishing firm of Harper and Row, and New York and Seventeen magazines.

The company owns 7 TV stations in the top 10 television markets in the country -- KTTV in Los Angeles, WTTG in Washington, WFLD in Chicago, WFXT in Boston, WNYC in New York, KDAF in Dallas and KRIV in Boston. Together these 7 stations reach 19.44% of the national audience, making Fox Broadcasting the fourth largest group owner of television stations in the country. The company owns Twentieth-Century Fox, one of the seven largest Hollywood production studios, a major producer of motion pictures and television programs for both network and syndicated exhibition, and a major syndicator of such programming to individual stations. Finally, the company has interests in home video distribution through CBS/Fox.

In 1988, News Corporation, Ltd. had overall revenues of almost $4.4 billion. Its newspapers made $346 million; its magazines made $77 million; its television division, including Fox Broadcasting Network and its owned stations, made $60 million, even though the network itself lost a reported $90 million in the 1987-1988 television season; and its filmed entertainment division made $88 million. It has been reported that this year the Fox Network will be profitable, several years ahead of the schedule it had set for turning its first profit. (See attached New York Times article, July 17, 1989).

News Corporation's dual role as network distributor and program supplier puts it in the unique position of being in direct competition with the other three networks through its Fox Broadcasting Network, while at the same time acting as a major supplier of television programs to them through Twentieth-Century Fox. In the 1988-1989 season Fox provided ABC with two hours of prime time programming, and it is currently scheduled to provide 1-1/2 hours this fall.

We do not object to Fox's large size and integrated operations. Nor do we object to its dual role as our program supplier and network competitor. What is objectionable is that Fox should be allowed to integrate its operations and play that dual role while its network competitors, and only its network competitors, should be forbidden to do so.

6. Do you believe that the Commission should retain its policies designed to promote minority ownership?

We have always supported and continue to support the Commission's policies designed to promote minority ownership.

7. Your companies are now permitted to own 12 TV, 12 AM and 12 FM stations. Are any of you seeking to buy more stations? What are the efficiencies of owning stations throughout the U.S.?

Broadcasting has been the business of Capital Cities/ABC since it was founded and it is the business our company knows best. We are always interested in acquiring additional broadcast properties. In television, further station acquisitions are unlikely because the eight stations we now own reach more than 24% of the national audience, and the legal limit is 25%. In radio, the 25% cap does not apply. We currently own 11 FM and 10 AM stations, which makes further acquisitions possible. In radio, our owned stations give us assured outlets in major markets for our radio networks, which offer several news program services. That interrelationship permits us to maintain and increase our investment in radio network programming. There are additional business efficiencies that derive from owning multiple stations. They include the sharing of information and experience with other radio operators and the ability to call upon station executives in the same corporate family for assistance in problem solving.

8. Do any of your companies own 2 broadcasting stations in the same market? If so, do those stations carry more news and

public affairs programming than a single station that you own in another market?

We own radio/television or AM/FM combinations in 14 markets and a single station in 5 markets. All of our stations, in both categories, offer significant amounts of news and public affairs programming. That is true even in radio, where programming type is largely determined by the format of the station. Each station's programming is independently designed to appeal to both community needs and to the particular station's audience based on the nature of the station's format. Comparisons between markets are not very useful or easily made because markets differ in their community needs and audience characteristics.

Question from Senator Exon

1. What significance is there in the Time/Warner/Paramount situation for the financial interest debate?

We understand why companies like Time and Warner chose to merge and why Paramount was interested in acquiring Time. They believe, as we do, that media companies must have wide-ranging capacity in both production and distribution in order to compete effectively with other large media companies here and abroad. Paramount and Warner, for example, have had significant interests in every aspect of both production and distribution. Both own Hollywood studios and are major producers of prime time programming for network broadcast. Both are major distributors of syndicated programming to individual stations. Both have interests in cable programming networks, motion picture theatres and home video distribution. Warner has been the fifth largest owner of cable systems and has interests in television stations. Paramount has an agreement to purchase television stations. Both companies are in the book publishing business and Warner is also a major force in the record business.

What is true of Paramount and Warner is also true of the other major studios -- MGM/UA, Columbia, Walt Disney, 20th Century Fox and MCA. They are all in both the production and distribution businesses -- producing programs for both network prime time and syndication and distributing programs in the syndication market. Fox also has its national over-the-air television network. All but one of the studio companies also have interests in either cable program services or television stations. All the studios have interests in other entertainment businesses such as records, publishing, videocassette distribution or motion picture theatres. Time brings to Time/Warner a variety of media interests. Time is a major magazine and book publisher. It is the second largest owner of cable systems (ATC), and it owns the two largest pay cable program services in America, HBO and CINEMAX.

We do not object to the Time/Warner merger, and we would have no quarrel with the fact that the studio companies are becoming increasingly integrated vertically -- so long as we are permitted the same opportunities to compete in the same range of production and distribution businesses. The studios resist any change in the rules that restrict the networks on the theory that the networks have unfair bargaining power in their dealings with the studios. In fact, it is the studios, all of whom are large, well-funded conglomerates, who have the advantage in negotiating with the networks.

Under the current rules, the studios can corner the market for creative production talent by offering what the networks are prohibited from offering -- more money up front, at the development stage of programming, in exchange for rights to share in the non-network broadcast value of successful programs. If the financial interest rule were eliminated, and if the production caps expire as scheduled, that unfair advantage would disappear and the financing sources available to producers, writers and directors would expand. The result would be a healthier, more competitive market than currently exists.

Senator INOUYE. Thank you very much, Mr. Murphy.
Mr. Tisch.

STATEMENT OF LAURENCE A. TISCH, PRESIDENT AND CEO, CBS, INC.

Mr. TISCH. Thank you, Mr. Chairman.

My name is Laurence Tisch, and I am President and Chief Executive Officer of the CBS Corporation. It is a privilege to appear before this distinguished committee today to discuss important issues that affect our Nation's network/affiliate partnership, which is the basis of our universal, free, over-the-air broadcast system.

We all know that the structure of American television has been dramatically altered. The statistics have become familiar. While today's video environment is being driven by consumer choice, government has tilted the playing field so that hundreds of millions of dollars, probably even billions of dollars, are being shifted arbitrarily each year from broadcasters to Hollywood and to cable.

That alone would be justification for regulatory reform, but there is something much more fundamental at stake in the growing threats to the historic structure of our Nation's broadcasting system. With all due respect, I ask the committee and the Congress to consider these questions.

Is it important that we continue to have universal, free, over-the-air television that provides the highest quality news, sports and entertainment programming to every American family and every home? Does it matter if major events, such as the Super Bowl, World Series, and Olympics move on to cable where they are available only to affluent Americans who would pay handsomely for what all Americans now enjoy for free?

What if we then had a two-tier broadcasting system with a second class, free programming service available to the less fortunate, who are disproportionately minorities, children, and the aged, located heavily in urban ghettoes and rural areas? Do we care about the capacity of locally operated stations, firmly rooted in each community, to provide local news, public affairs, and community service broadcasting?

To understand the seriousness of these questions, let us explore the impact of current government regulation of broadcasting, beginning with the financial interest and syndication rules. Unlike every other participant in the programming process—writers, talent agents, syndicators, studios, and others—the networks that finance, promote and distribute programs are the only ones prevented from entering into reasonable commercial arrangements with producers to share the risks and share the rewards. That deprives us of the ability to use creative ways to finance new products, to compete on an equal basis with other media, and to reap the normal profits that can flow from a hit show. The predictable result is likely to be a weakening of our ability to finance the kind of first class product that has been the proud standard of American network television.

The unintended effect of this rule has been to increase deficit financing, which has strengthened the competitive power of the deep pocket, major Hollywood studios as compared to the smaller, independent producers. For that reason, any settlement of this issue must be particularly protective of the interests of the smaller, independent producers who bring so much creativity and vitality to our business, but who lack the significant resources of either the studios or the networks.

In arguing against any change in these rules, the Hollywood studios talk about a sacrosanct distinction between production and distribution. That may have been true 15 years ago, but look again at the studios. Four of them own cable networks, five own interests in television stations, and even one has its own television network.

And yet, Hollywood insists that the restrictions that prevent the networks from participating in this changing economic order must remain inexorably set in stone forever. This is both illogical and contradicted by the daily behavior of the major studios as they rush to find new ways to participate in the evolving economics of video, while desperately seeking to deny the networks the same opportunities.

I, for one, do not relish a grand battle with the creative community over this issue. Our long-term common interests exceed the stakes involved in this dispute. It is for that reason that I am hopeful that a settlement can be reached which will permit the networks to join with Hollywood in commercially reasonable financial arrangements, just as the producers do with every other member of the industry.

Another example of the distorting impact of current government regulations is in our relationship with cable. Under existing law, cable systems are permitted to take network and local broadcast signals without obtaining the consent of the broadcasters and without making any payment for the use of the programming. In effect, current law forces broadcasters to subsidize our rivals in the cable industry.

Such an arrangement may have been justifiable years ago when cable did not compete with broadcasters for audiences, programming, and advertising dollars. In those days it could have plausibly been argued that free cable transmission was beneficial for both industries. However, the situation today is very different. Cable no longer limits its offerings to broadcast retransmissions. Indeed, it has utilized free carriage of local broadcast signals as the basis on which it has built and financed an array of cable exclusive channels that are now systematically attacking virtually every aspect of the broadcasting business.

We have already seen the beginning of the movement of major events from broadcast television to cable. If the current, unfair regulatory structure continues, many of television's most expensive and popular programs will be enticed onto cable where they will be available only to those able to afford increasingly higher cable rates.

Make no mistake about it. The long-term availability of the Super Bowl, the World Series, and the Olympics to all Americans over free television is in serious jeopardy. As more and more events and programs migrate to cable, those viewers who are able to subscribe are effectively depriving families without cable of much of what all Americans now receive free.

Based on current trends, our system of universal, free television is rapidly being replaced by a two-tier system under which the best and most popular programming goes only to those able to pay. The continued weakening of our over-the-air broadcast system would also diminish the ability of local stations to provide local news, public affairs, and community programming.

Our network affiliate system is unique in the world, because of its heavy emphasis on local control and responsiveness to local and regional tastes and needs. Remember, our networks are really composites of hundreds of stations rooted in every community in America. The continued siphoning of funds, programming and audiences from the networks by cable under the aegis of Federal regulations must inevitably damage the localism inherent in our broadcasting system.

Mr. Chairman, these regulations sap the creative, financial, and competitive strength of the network affiliate system. Meaningful regulatory reform must become an urgent priority.

Again, Mr. Chairman, I thank you for the opportunity to present my views on this very important subject.

[The statement and questions and answers follow:]

BEFORE THE SUBCOMMITTEE ON COMMUNICATIONS OF THE SENATE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION

Statement by Laurence A. Tisch
President and Chief Executive Officer, CBS Inc.
June 22, 1989

Senator Inouye and Members of the Subcommittee:

I appreciate the opportunity to be here today to take part in your overall review of the changes that are taking place in the American media marketplace and whether these changes raise issues of undue concentration that may justify government intervention. It is clearly important that policymakers document and understand these developments and their effects on domestic communications policies and goals. These hearings are an important part of that process.

I bring to these proceedings the perspective of a uniquely American industry -- broadcasting -- and a time-honored business arrangement -- the network/affiliate partnership. The theme of my remarks is that government regulation -- new and old -- must be applied in a comprehensive and even-handed manner so that broadcast networks and their affiliates can compete on a fair and level playing field in their efforts to remain viable in the modern video marketplace.

Clearly, the broadcast networks operate in a competitive regulatory and technological environment today that has become extraordinarily complex, and it is growing more complex every day. As explained more fully below, the audiences of the networks and their affiliates have, in recent years, steadily declined in the face of a proliferation of new video channels.[1] Today's average viewer is able to choose from among dozens of cable channels geared either to mass audiences or to specialized audiences of all ages and interests. Cable subscribers and others can use their VCRs to watch a rented movie or a program taped last week or last year. The number of independent stations has also multiplied and many viewers now own satellite dishes.

On the advertising side, we compete now in a crowded national advertising marketplace with cable networks and independent stations. On the program acquisition side, our Hollywood suppliers are becoming multi-media enterprises which can no longer credibly claim that any of the broadcast networks are their only customer for first-run program product.

CBS does not shirk from any of this new competition and does not seek any special protection. However, the deregulation of cable, the profusion of other unregulated competitors in the video marketplace, and the vertical and horizontal integration of our program suppliers on a global basis all point up the anachronism of the ancient scheme of constricting regulation of the commercial television networks.

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[1] In 1970, the average TV home received 6.8 broadcast stations. Tentative Decision, 94 F.C.C.2d 1019, 1055 (1983). In 1988, the average home received 27.7 signals. Nielsen Television Index Special Release, Television Audience 1988 9 (1988).

Before I give you some facts and figures to demonstrate the changes in the marketplace and a summary of what I regard as some of the most onerous network rules, let me try to explain why I believe that discriminatory network regulation should be of concern to the Congress.

Out of the array of video technologies that now compete for television viewers' attention, only one is free to the consumer and only one is universally available -- broadcasting. And only broadcasting has accepted the responsibility to provide a national and local program service responsive to the needs and interests both of the nation as a whole and of local communities across the country. The preservation of this unique broadcast system that allows virtually every household free access to a distinctive blend of national and local public service should, in my view, remain a fundamental government policy goal.

The network/affiliate relationship is the cornerstone of free over-the-air broadcasting in this country. It is a unique partnership that provides a combination of national and local news, public affairs, sports and entertainment to virtually every household in America. The quality and popularity of a network's programming translates into the financial wherewithal to invest resources in community-based news, public affairs and other activities that involve both good citizenship and good business. It goes without saying that local broadcast affiliates all over the country have community ties that cannot be approached by local cable systems or by other video competitors.

On the national level, the ability of broadcast networks to reach virtually every American home simultaneously through their local affiliates involves responsibilities that we have always taken extremely seriously. In 1963, the broadcast television networks brought to every home the horror of the assassination of President Kennedy and its aftermath with an immediacy that was possible in no other way. In 1969, the first manned landing on the moon was watched by millions of people as it happened; indeed, we are planning a special broadcast to be aired next month in commemoration of the 20th anniversary of that event.

Our national political conventions and campaigns are covered by the television networks with thoroughness and depth that provide a heightened universal sense of participation in the process of self-government. Just last month, CBS News was in China with live special reports on the fascinating events unfolding there. And you didn't have to be a paying cable subscriber to share in these dramatic historic events that shape our own sense of national identity.

Obviously, there are many more examples that could be given of the important contributions that the television network news organizations have made in bringing together our far-flung, disparate nation in times of crisis or triumph. This role is one that we accept enthusiastically and is a subject of pride to all of us at CBS.

The nationwide service that characterizes the network/affiliate partnership also serves the public interest in other ways. For example, the networks commit huge sums to acquire the rights to special attractions of universal significance -- the Super Bowl, the World Series, the Olympics -- that bring us together as a people and that the public has come to expect to be universally accessible on free broadcast television. I recognize, of course, that we buy these rights with the hope that we can turn a profit. But our self-interest does not matter to the public, which has come to share these events as a national community -- without regard to economic status or geographic happenstance. By contrast, the pay media, which are unshackled by the burdens of network regulations, would love to offer these attractions to the relatively small audiences who are willing to pay a very substantial sum for exclusive access.

The onerous and discriminatory regulation of the broadcast networks has been rationalized by some on the basis that the networks were "dominant" over -- depending on whom you asked -- major studios, syndicators, the cable industry, or broadcast stations. I was not in this business 20 years ago when many of the network rules in effect today were being considered for adoption, but this concept of "network dominance" today no longer has any meaning.

First, the notion of "network dominance" discounts the intense competition that exists among the networks themselves. There is simply no monolith called "the networks." CBS, in buying and scheduling television programs, has to make sure -- first and foremost -- that it is competitive with ABC and NBC. For example, the preparing of our network schedule for the upcoming season is undertaken only after the most intense study of the strengths -- and the weaknesses -- of ABC and NBC and with the overriding goal of improving our relative competitive position. There is nothing more important to me than that the CBS prime-time entertainment line-up regain its historic leadership position; a "hit" is cheap, no matter what the price.

Second, those who blithely refer to "network dominance" seem to me to confuse market power with popularity. There is no doubt but that the effectiveness of the network/affiliates partnership has resulted in combined local and national program services that are extremely popular with the television audience. Even today, when the overall viewing share of affiliated stations is down to 52 percent in cabled homes,[2] individual prime time network offerings are the highest rated programs on the cable systems, day after day, week after week. Since dozens of alternative programs are just as conveniently available as network programs on the typical cable system, those viewing levels can only be explained by the quality of the network programming and the loyalty of the local audience to the local affiliate. They have nothing to do with any supposed network "stranglehold" on the viewing audience.

And finally, whatever one thinks about the historical accuracy of the phrase "network dominance," its use today as an excuse to disadvantage three homegrown American competitors in this new complex marketplace is ludicrous. Indeed, when we take a closer look at the changes in the television industry since the early 1970s, it is abundantly clear that the age of network dominance -- if it ever existed -- has "gone with the wind."

As a result of revolutionary regulatory, technological and marketplace changes, there has been an enormous increase in competition for viewing audiences. Take cable for example. In 1970, when many of the regulatory restraints were imposed on the broadcast networks, the cable industry's principal function was to improve viewers' reception of nearby broadcast signals.[3] Thus, cable was concentrated in rural areas and served only 4.5 million television households.[4] Within a short time, however, the advent of cable networks made cable marketable to viewers who already enjoyed high-quality reception of over-the-air television broadcast signals.[5] As a result, the number of basic cable subscribers exploded in the 1980s, reaching 28 million in 1983 and over 45 million in 1988.[6] See Figure 1. (All figures appear at the end of the text.) From a meager beginning, the number of subscriptions to pay-cable services mushroomed from 18,000 in 1973 to more than 37 million in 1988 -- an increase of more than 2050-fold in only 15 years.[7] See Figure 2. Growth in industry revenues has been equally stunning. In 1988, basic cable revenues exceeded $7.6 billion.[8] See Figure 3. Revenues from pay cable skyrocketed from $68 million in 1976 to $2.8 billion in 1983 and to nearly $4.3 billion in 1988.[9] See Figure 4.

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[2] National Cable Television Association, Cable Television Developments 5 (Aug. 1988).

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[3] Tentative Decision, 94 F.C.C.2d at 1056.

[4] Id.

[5] As reported recently: "Where there was only one cable programming service in 1975, HBO, there are expected to be 110 by 1990." Wash. Post, June 15, 1989, at E-3. Over 30 of these services now exceed the ten-million subscriber mark. Cablevision, Mar. 13, 1989, at 36.

[6] Tentative Decision, 94 F.C.C.2d at 1057; Cable TV Investor, Apr. 27, 1989, at 8.

[7] Paul Kagan, Kagan Cable TV Financial Databook 14 (June 1988); Cable TV Investor, Apr. 27, 1989, at 8.

[8] Cable TV Investor, Apr. 27, 1989, at 8. In 1970, basic cable revenues were $337 million -- or only about 4 percent of their 1988 level. See Paul Kagan, Kagan Cable TV Financial Data Book 12 (June 1988).

Cable has now matured into an economic powerhouse estimated to be worth about twice the value of the entire broadcasting business.[10] In the words of the National Telecommunications and Information Administration, "the American cable industry has gone from a relatively minor commercial adjunct to the over-the-air television broadcasting business to the dominant video distribution medium in the country."[11]

Perversely, much of cable's current prosperity is based on the subsidy extracted from broadcasters under the existing free compulsory license for cable retransmission of network and local broadcast signals. As stated in one recent analyst's report:

> In our view it is fair to say that the networks account for much of the value of the cable service for which subscribers now pay about $13 billion annually. It is clear cable operators and cable originated program services are essent-

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[9] Paul Kagan, Kagan Cable TV Financial Databook 12 (June 1988); Cable TV Investor, Apr. 27, 1989, at 8.

[10] Broadcasting, Sept. 26, 1988, at 35.

[11] U.S. Department of Commerce, Video Program Distribution and Cable Television: Current Policy Issues and Recommendations, NTIA Report 88-233 at 1 (June 1988) ("NTIA Report"). The head of the Cable Television Advertising Bureau reportedly has stated that "there are now 'two television universes' in the nation, and cable is now the dominant one, offering the most choices to the most viewers." N.Y. Times, Mar. 21, 1989, at D-23.

> ially subsidized by the broadcast networks and television stations.[12]

As a result of the Cable Act of 1984, cable has now been able to use its position in each market to exploit fully the willingness of some viewers to pay for the retransmission of broadcast signals. In the three years since cable rate deregulation, subscriber charges have risen an average of 29 percent.[13] Cable has therefore taken the billions of dollars obtained from consumers for the retransmission of broadcasters' signals and financed unregulated assaults on regulated broadcasters.[14] How is that fair?

Furthermore, all indications point toward a future expansion of cable's financial position during the 1990s. Industry experts estimate that by 1995, 89.3 million households will be passed by cable, and the number of basic cable subscribers will exceed 60 million.[15] Basic cable revenues are expected to be over $16 billion in that year, and total cable revenues are expected to increase from $13.7 billion in 1988 to over $27 billion in 1995.[16] See Figure 5.

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[12] Merrill Lynch Capital Markets, The Year Ahead: Broadcasting 43 (Dec. 13, 1988). See also Broadcasting, Apr. 10, 1989, at 25.

[13] U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index for Cable Television (index at December 1983 = 100, index at December 1985 = 112.5 and index at March 1989 = 145.1).

[14] As NCTA President and CEO Jim Mooney stated in recent congressional testimony: "Since deregulation, the cable industry has been reinvesting its additional revenues to upgrade its service offerings. In particular, the cable industry has substantially increased its investment in cable programming." Statement of James P. Mooney Before the Subcomm. on Antitrust, Monopolies and Business Rights of the Senate Comm. on the Judiciary at 97 (Apr. 12, 1989).

[15] Cable TV Investor, Apr. 27, 1989, at 8.

The growth in prerecorded home video and independent broadcasting has also intensified the rivalry for television audiences. VCR penetration jumped from 2.1 million homes in 1983 to 53.4 million just five years later and is expected to reach 73 million homes by 1995.[17] See Figure 6. At the same time, the number of independent stations grew over 400 percent between 1970 and 1988.[18] See Figure 7. Total audience share for independents in the top 50 markets increased from 14 percent in 1980 to 21 percent in 1987.[19]

The broader reach of independent television stations has permitted Fox to form its networking operation. Fox, which reaches 89 percent of television households through 129 stations,[20] now programs two evenings per week and has recently announced plans to commence a third night of programming.[21]

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[16] Id. at 9.

[17] Tentative Decision, 94 F.C.C.2d at 1060; VCR Letter, Mar. 8, 1988, at 3.

[18] Tentative Decision, 94 F.C.C.2d at 1055; Arthur Young & Co., TVB Station Time Sales (Year End 1988) (prepared for Television Bureau of Advertising).

[19] NTIA Report, supra note 11, at 68 & authorities cited therein.

[20] Wall St. Journal, Feb. 28, 1989, at B-6.

The growth and maturation of alternatives to the traditional broadcast networks has only intensified network competition for audiences. No longer can we be assured of a 20-share program simply because audiences had few places to go. As a consequence, the fierce ratings war among CBS, ABC, NBC, Fox and others, has become increasingly volatile and highly visible. Indeed, in what other industry is competition calculated hour-by-hour by national measurement services? And in what other industry are the daily and weekly shifts in market share chronicled in the media?

In the modern video marketplace, the rivalry for audience is reflected in an intensified competition for advertising dollars. Cable advertising grew from $58 million in revenues in 1980 to $1.45 billion in 1988.[22] See Figure 8. In addition, barter, which was non-existent in 1970 and amounted to only $50 million in 1980, will be a $1 billion business in 1989.[23] See Figure 8.

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[21] N.Y. Times, Apr. 3, 1989, at D8. Indeed, Fox apparently intends to program all seven nights "in as little as 18 months." Wall St. Journal, May 25, 1989, at B1.

[22] Paul Kagan, Kagan Cable TV Financial Databook 74 (June 1988); Cable TV Advertising, April 27, 1988, at 3.

[23] Advertiser Syndicated Television Association, Guide to Advertiser Supported Syndication 16 (supplement to Advertising Age (Mar. 27, 1989)). Nearly 120 series and more than 300 movies and specials are now being offered on a barter basis. Id. at 17.

Furthermore, the rivalry for audience and advertising, together with the growth of pay-television networks, has greatly increased the competition for television programming. It was estimated that cable alone would spend roughly $2.5 billion on programming in 1988.[24] Pay cable and home video now provide the first television exposure for top theatrical motion pictures, which were once one of the most popular forms of network television programming.[25] Cable networks also have become key players in the bidding for rights to major sporting events, including NFL football, and are expected "to make regional sports networks -- with big league sports programming -- a driving force behind the industry's next growth spurt."[26] It has been suggested that cable's dual revenue stream -- from advertising sales and subscriber fees -- might give it the advantage over the broadcast networks in competing even for such big-ticket events as major league baseball and the Olympics.[27]

The three broadcast networks also face stiff competition for entertainment series resources and inputs. For instance, the Fox network offers first-run action-adventure programming

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[24] Wilkofsky Gruen Associates, Television 1995 59 (1989).

[25] As early as 1983, HBO alone was identified as "the principal source of film finance." The Economist, July 30, 1983, at 73.

[26] Wall St. Journal, Apr. 25, 1989, at B1.

[27] Advertising Age, Apr. 11, 1988, at S-10 - 12.

(21 Jump Street), situation comedy (Married . . . With Children) and variety (The Tracy Ullman Show). In bidding for such programming rights, Fox's owner, Rupert Murdoch, has publicly expressed his determination that the programs he purchases will be of "the highest possible quality" and has stated that Fox has not "spared anything" in terms of program investment.[28]

First-run syndication is another potent source of competition for original programs. While only 45 first-run shows were available in 1983, 113 were offered in 1988.[29] Suppliers report that the use of cash-and-barter deals allows them to sell shows in first-run syndication for "much higher prices than are paid by the networks."[30] Cable networks also are active in the development of original programming[31] and are even taking advantage of broadcast syndication as a means of financing original program production.[32]

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[28] Broadcasting, Apr. 13, 1987, at 72. In addition to entertainment series, Fox purchased the national television rights to the Emmy Awards. Emmy Magazine, July/Aug. 1987, at 56 ("In a major programming coup, Fox outfoxed, or at least outbid, the three major networks. FBC will pay $4.7 million for a three-year package that also includes the Academy of Television Arts & Sciences Hall of Fame presentation. . . .")

[29] Channels, Jan. 16, 1989, at 28.

[30] Janney Montgomery Scott, Gulf & Western Inc. Progress Report 2 (Feb. 14, 1989). In the case of Star Trek: The Next Generation, Paramount generated "about twice the revenue per first-run episode over what the networks would pay." Id.

[31] Television/Radio Age, May 15, 1989, at 39-43 (original productions include dozens of films, specials and entertainment series).

We estimate that our share of television entertainment program purchases in 1988 has dropped to between 8 and 18 percent, depending on which of our competitors are included -- hardly a "dominant" position.

Thus, since 1970, the rivalry among CBS, ABC and NBC has intensified and each has faced intense new competitive challenges. Existing video outlets have expanded and many alternatives have become available; powerful new networking companies have provided diverse and specialized programming to consumers; and pay services and barter have joined conventional advertising as important means of program support.

It is hardly surprising that this increased competition has been felt by each of the conventional broadcast networks in terms of declining audience shares. Prime-time ratings for the three networks have fallen from 56.3 in the 1969-70 season to 41.3 in 1988-89.[33] In addition, the total audience share for the three networks fell from 90 percent in 1970 to 67.2 percent this year.[34] Network television advertising revenues also have stagnated; in 1987, the three networks earned only 35 percent of all broadcast and cable advertising revenues, down from 47 percent in 1977.[35] At the same time, the networks are facing dramatic increases in programming costs[36] and, together with their affiliates, they have been forced to subsidize one of their most potent competitors, cable, by means of the existing royalty-free compulsory license for cable retransmission of local broadcast signals.

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[32] Id. at 39 ("syndication is mounting in importance as a way of paying the bills in advance for new [cable] productions.")

[33] Electronic Media, May 1, 1989 at 68; N.Y. Times, Apr. 19, 1989, at A1.

[34] Tentative Decision, 94 F.C.C.2d at 1058; N.Y. Times, Apr. 19, 1989, at A1.

I recognize that this lengthy recitation of the growth of our competition may leave a certain "doom and gloom" impression. But, in fact, I have a great deal more faith in the future of network television than some commentators who have gone so far as to predict that our "decline is inexorable."[37] Indeed, we have only begun to fight to ensure the vitality of network broadcasting.

To succeed on this mission, we need no special advantages, but we do need access to the same competitive tools and opportunities that are available to others in the marketplace. In recent years, while other elements of the television industry have benefitted from a large-scale program of deregulation, the broadcast networks continue to be shackled by 1940s-style business regulations that effectively increase our programming costs. In addition, these regulations prevent the networks from taking advantage of efficiencies that our competitors are able to achieve through integration into various aspects of the television business. Among other things, these rules preclude the networks

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[35] Network Broadcasting, FCC 89-89 at 384 n.21 (released Apr. 7, 1989).

[36] Marketing & Media Decisions, Feb. 1988, at 76 ("TV production costs are climbing -- hitting $500,000 for some half-hour sitcoms and more than $1 million for hour-length dramas.").

[37] Wall Street Week broadcast Apr. 21, 1989 (statement of Richard MacDonald, Senior Broadcast Analyst, First Boston Corporation, transcript at 35-36).

- -- from engaging in the domestic television syndication business and, with minor exceptions, from participating in foreign syndication;[38]
- -- from acquiring a financial interest in "back-end" distribution rights;[39] and
- -- from owning cable television systems.[40]

As discussed in the attached Technical Appendix, the FCC's professional staff, the Departments of Justice and Commerce and the Federal Trade Commission have examined these regulations over the years and found them to be antiquated, counterproductive and inconsistent with the goals of diversity and competition.[41] These conclusions are even more compelling today because of the rapid changes in the marketplace. Ted Turner has stated that "if you just have distribution today, and that's basically what the three networks have, you're very vulnerable."[42] Hollywood studios can now own movie theatres, cable systems, cable program networks, home video distributors, broadcast stations and syndication divisions, in addition to their film and television production operations.[43] Similarly, in the cable industry, every one of the top ten MSOs has ownership interests in program networks.[44]

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[38] 47 C.F.R. § 73.658(j)(i) (1988).

[39] Id. § 73.658(j)(ii).

[40] Id. § 76.501(a)(1).

[41] See Technical Appendix infra & authorities cited therein.

Furthermore, in explaining the reasons behind the various combination proposals, Time, Warner and Paramount each have emphasized the need to draw upon the efficiencies of a multi-faceted corporation in order to survive in the face of aggressive foreign competition. For example, Time and Warner have said:

> Time and Warner, separately strong and creative companies, have joined to meet this international competition head-on as a leading U.S. entertainment, communications and publishing company. Our central objective is to be competitive, and this requires a strategic merger, a

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[42] Broadcasting, Aug. 17, 1987, at 50.

[43] See, e.g., id. at D22 (MCA owns Universal Studios, WWOR-TV and 49 percent of Cineplex-Odeon; Gulf and Western owns Paramount, television stations and movie theatres; Viacom owns television stations, a television production company, cable systems and cable networks).

[44] NTIA Report, supra note 11, at 73, ("[t]he accelerated pace of vertical integration within the cable industry in the past several years suggests the importance placed upon it.").

> proactive approach that will help redefine the profile of American business in the international marketplace.[45]

Indeed, without the merger, all these companies have suggested they would be required "to enter this fight with our arms tied behind our back."[46]

While other powerful U.S. media companies prepare to respond to competitive challenges from abroad, we in the network television business truly do have our arms tied behind our backs. The pervasive network regulations are clearly anachronistic and counterproductive in today's video environment, and their continued existence is particularly poor policy given the importance of stimulating U.S. competitiveness. CBS, ABC and NBC are thoroughly American in their orientation and ownership and are almost certain to remain so, thanks, in part, to Section 310 of the Act. Clearly, these important American institutions should be given a fair opportunity to compete so that they can continue to serve as a vital component of the free over-the-air broadcasting system in the 1990s and beyond.

Thank you.

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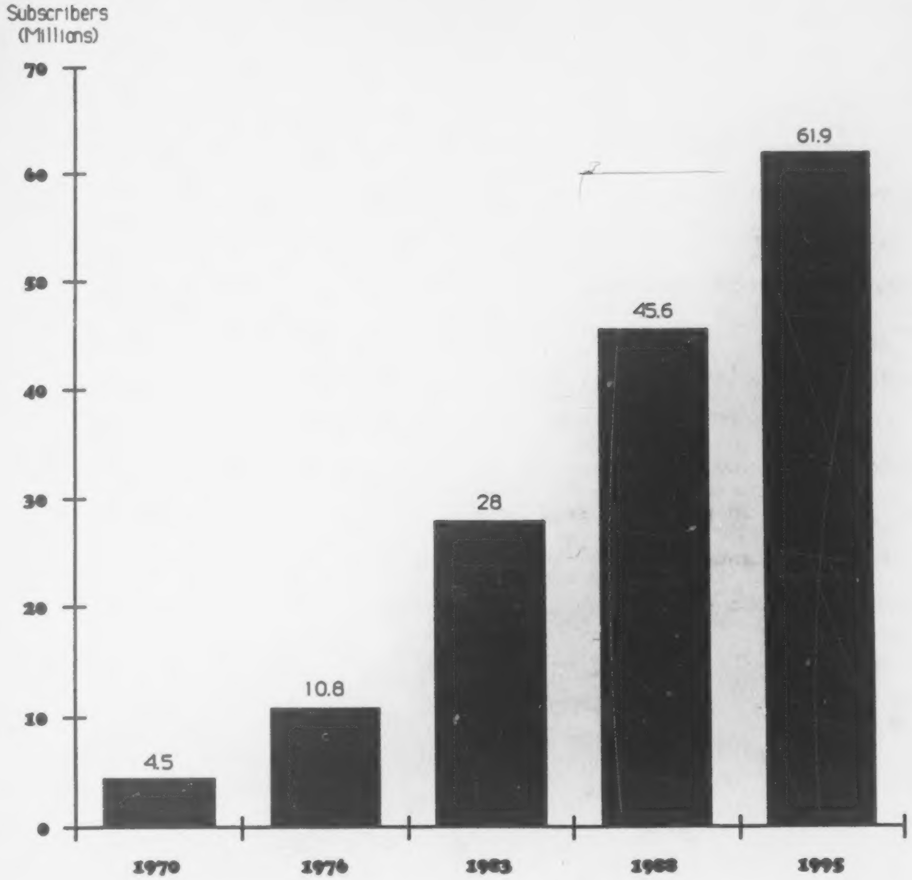
[45] Joint Testimony of J. Richard Munro, Chairman and CEO, Time Inc. and Steven J. Ross, Chairman and CEO, Warner Communications Inc. Before the House Subcommittee on Economic and Commercial Law, Mar. 14, 1989, at 11.

[46] Oral Testimony of J. Richard Munro, Chairman and CEO, Time Inc. Before the House Economic and Commercial Law Subcommittee, Mar. 14, 1989, at 6. See also Wall St. Journal, June 8, 1989, at A12 (Paramount chief Martin Davis says that together Time and Paramount "will be the foremost American communications company, capable of competing more effectively on a world-wide scale against foreign media giants.")

Figure 1

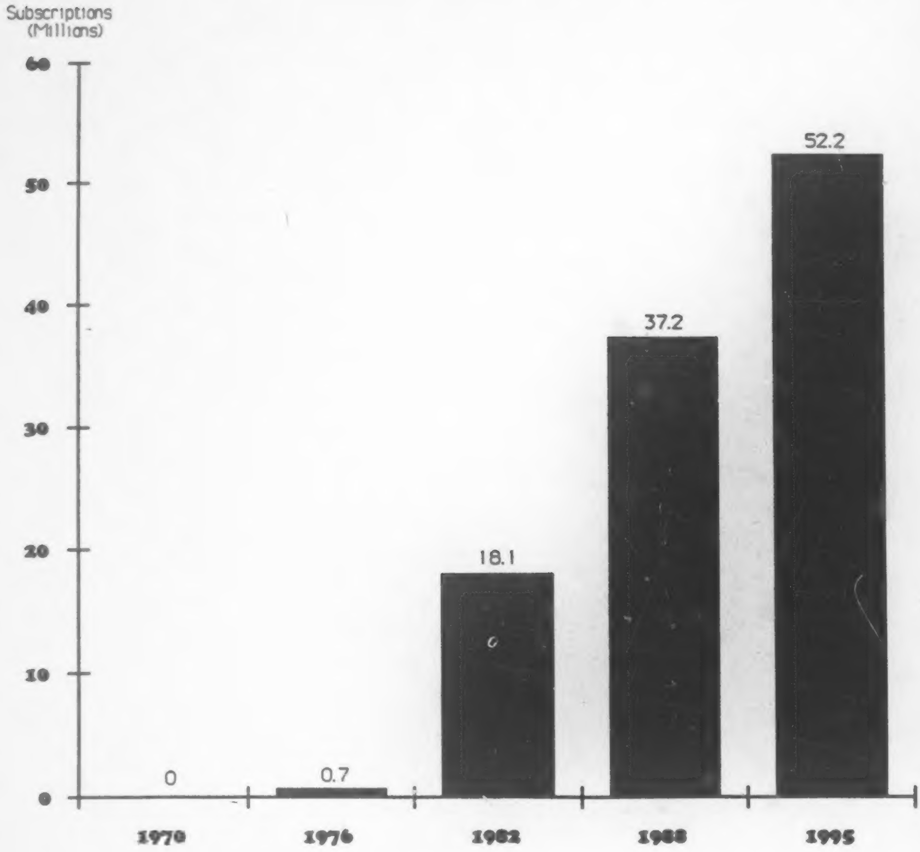
ACTUAL AND PROJECTED GROWTH OF BASIC CABLE: 1970-1995



Sources: Cable TV Investor, April 27, 1989, at 8; Tentative Decision, 94 F.C.C.2d 1019, 1057 (1983); Warren Publishing, Inc., Television and Cable Factbook C-374 (1989).

Figure 2

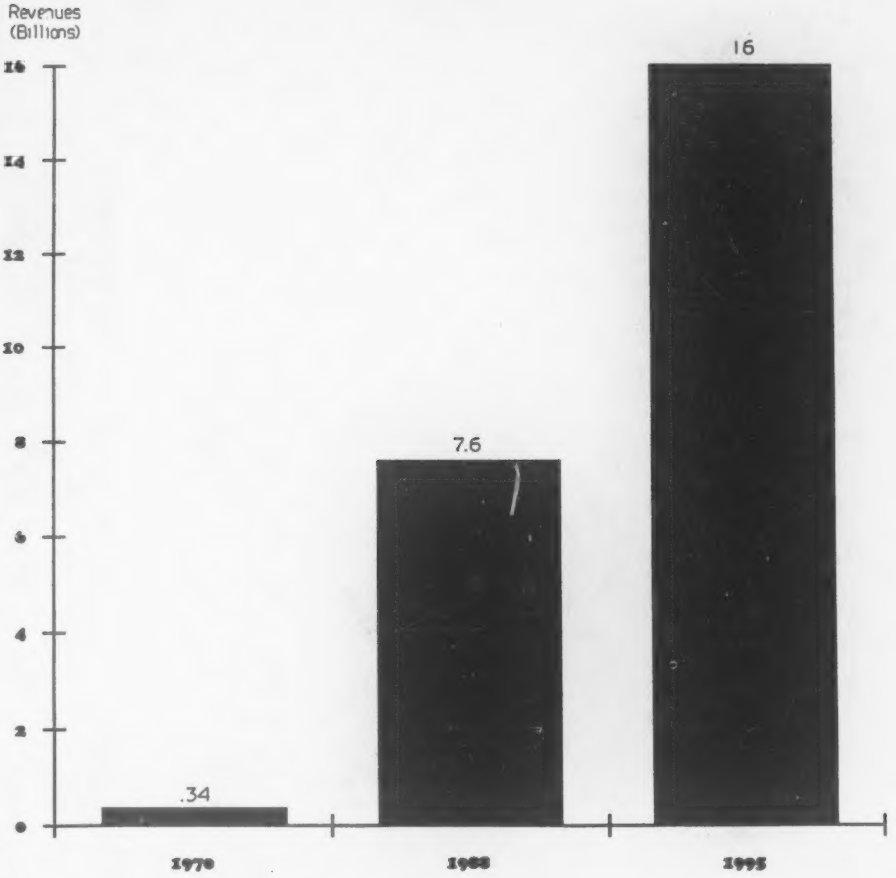
ACTUAL AND PROJECTED GROWTH OF PAY CABLE: 1970-1995



Sources: Paul Kagan, Kagan Cable TV Financial Databook 12 (June 1988); Cable TV Investor, April 27, 1989, at 8.

Figure 3

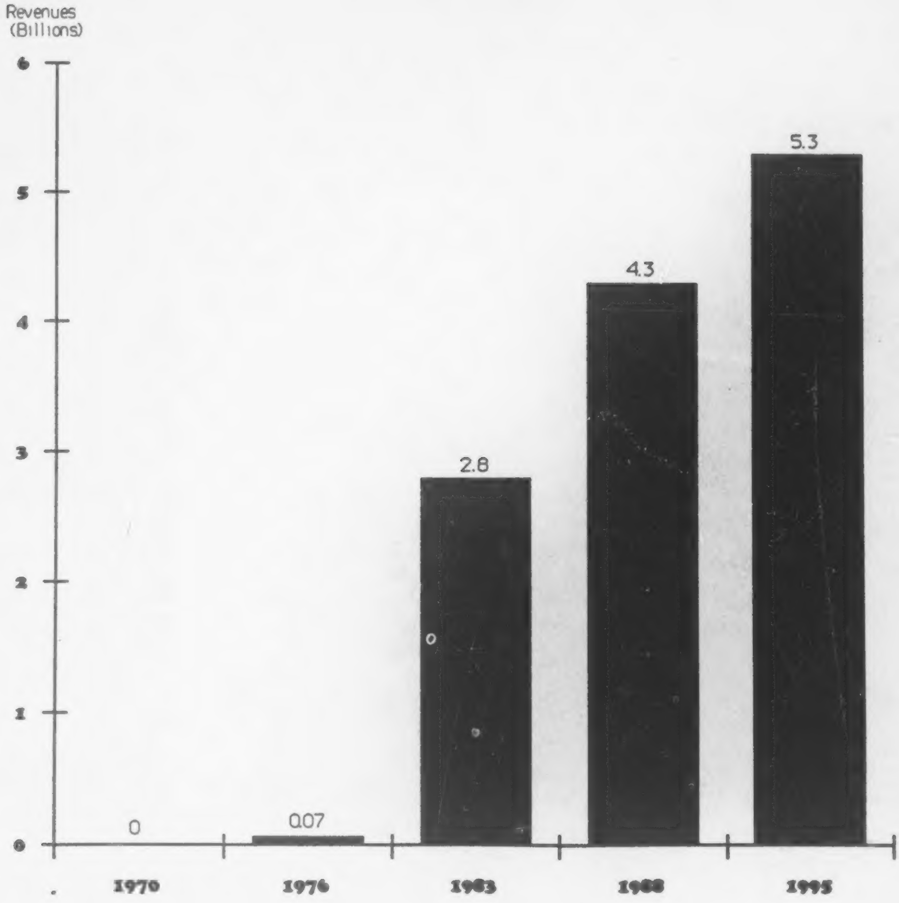
ACTUAL AND PROJECTED GROWTH OF BASIC CABLE REVENUES: 1970-1995



Sources: Paul Kagan, Kagan Cable TV Financial Databook 12 (June 1988); Cable TV Investor, April 27, 1989, at 8.

Figure 4

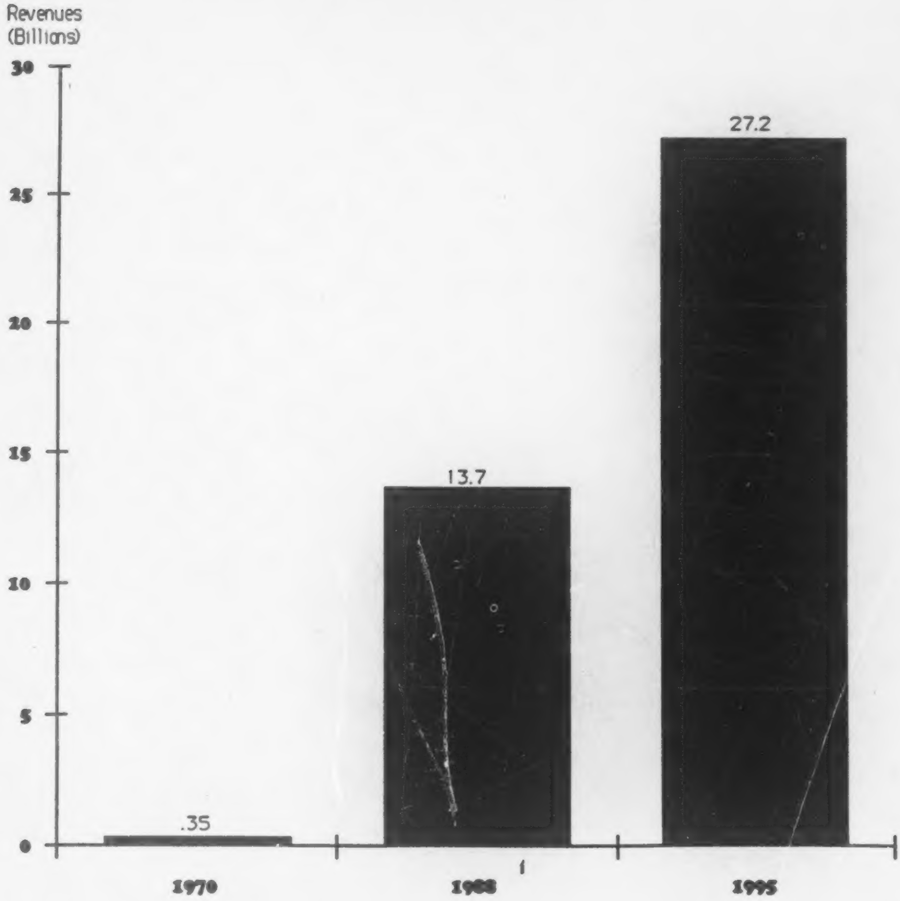
ACTUAL AND PROJECTED GROWTH OF PAY CABLE REVENUES: 1970-1995



Sources: Paul Kagan, Kagan Cable TV Financial Databook 12 (June 1988); Cable TV Investor, April 27, 1989, at 8.

Figure 5

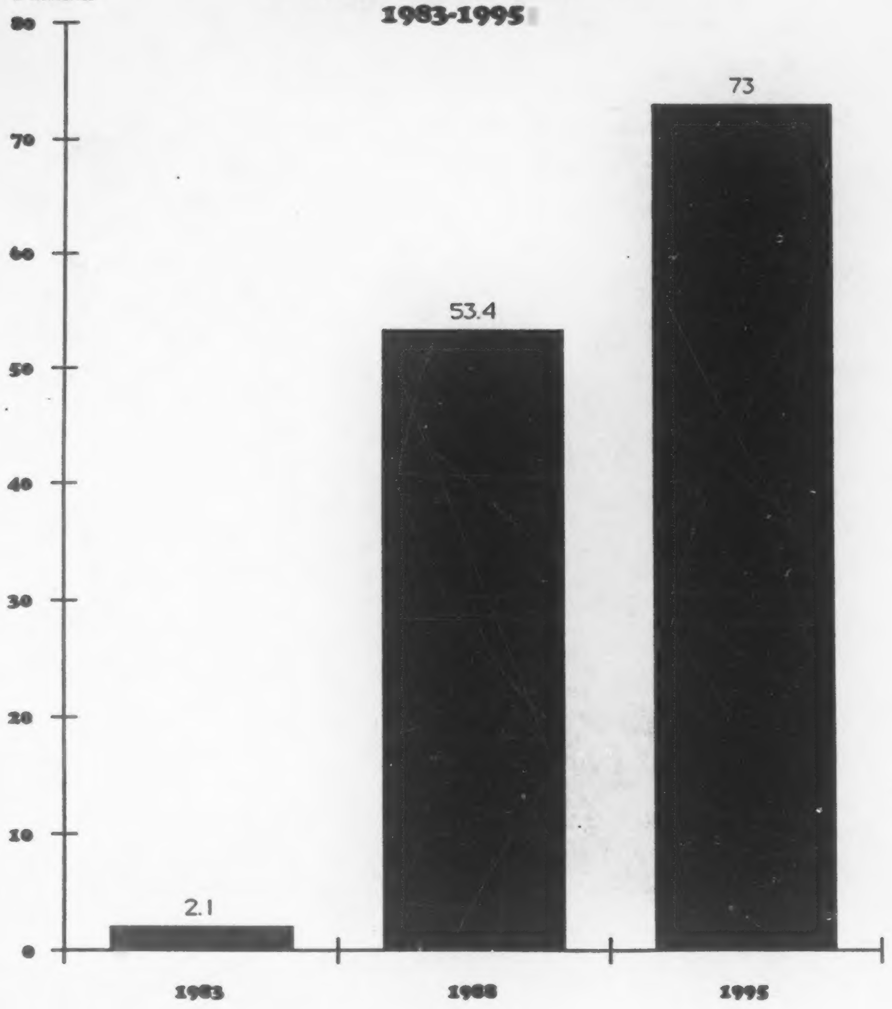
ACTUAL AND PROJECTED GROWTH OF TOTAL CABLE REVENUES: 1970-1995



Sources: Paul Kagan, Kagan Cable TV Financial Databook 12 (June 1988); Cable TV Investor, April 27, 1989, at 9.

Figure 6

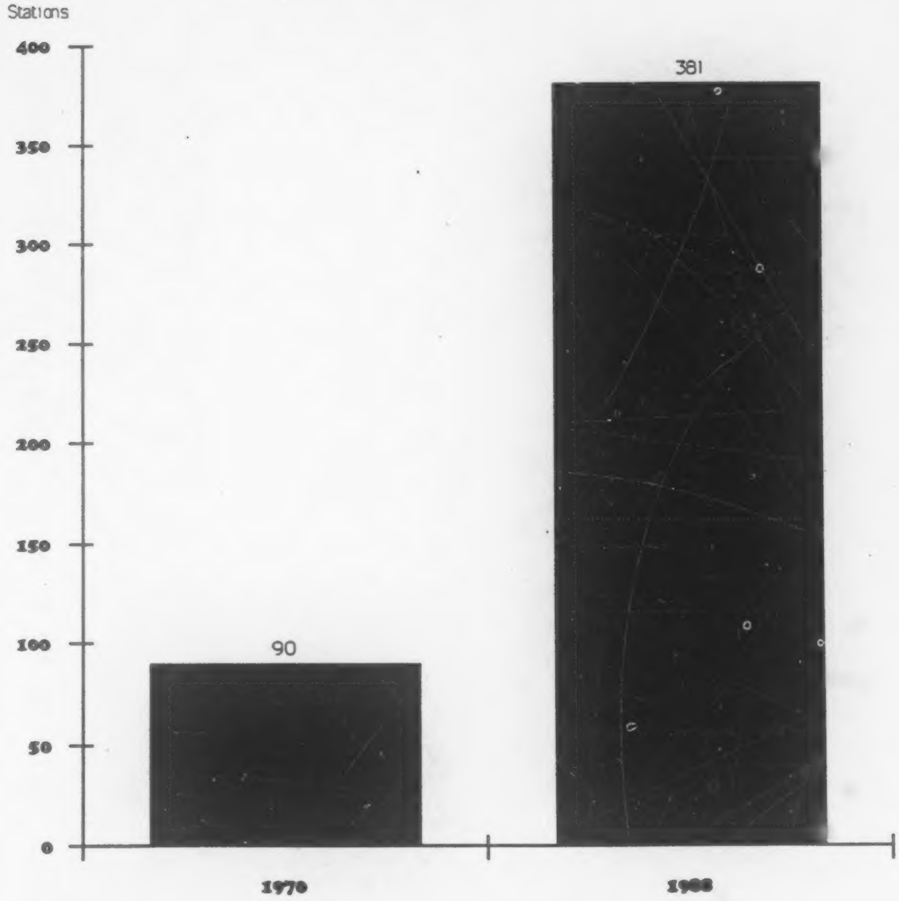
ACTUAL AND PROJECTED GROWTH OF PRERECORDED VIDEO: 1983-1995



Sources: Tentative Decision, 94 F.C.C. 2d 1019, 1060 (1983); VCR Letter, March 8, 1988, at 3.

Figure 7

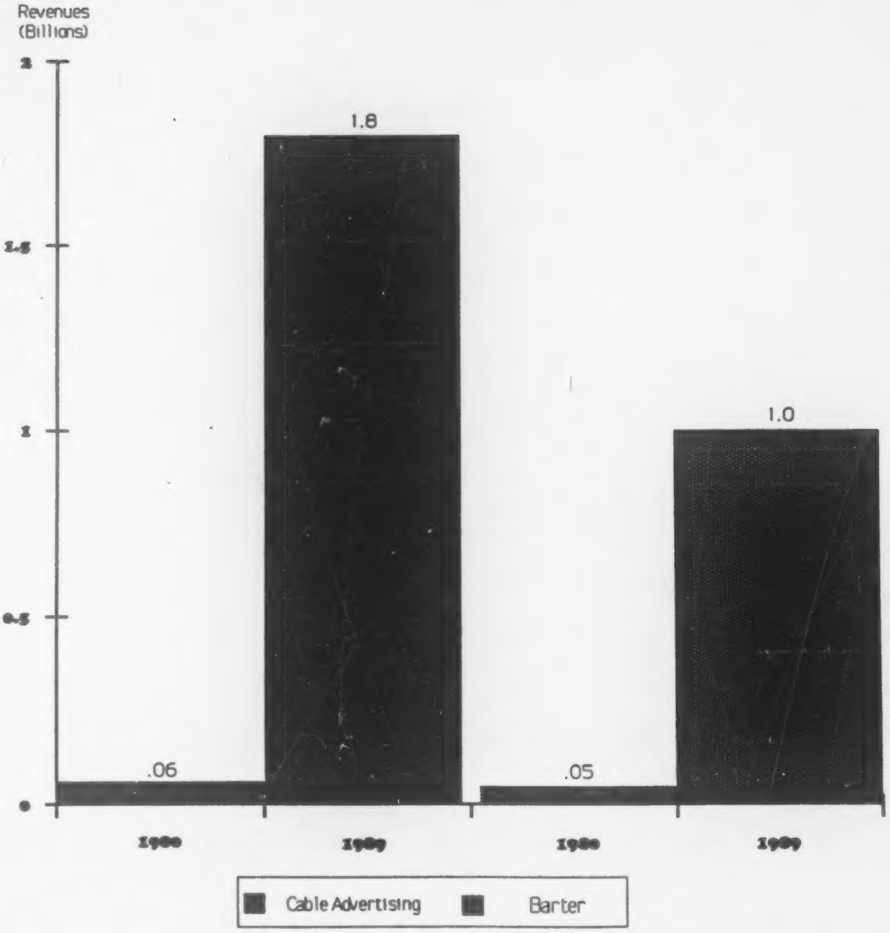
GROWTH OF INDEPENDENT BROADCAST STATIONS: 1970-1988



Sources: Tentative Decision, 94 F.C.C. 2d 1019, 1055 (1983); Arthur Young & Co., TVB Station Time Sales (Year End 1988) (prepared for Television Bureau of Advertising).

Figure 8

ACTUAL AND PROJECTED GROWTH OF TOTAL CABLE ADVERTISING AND BARTER: 1980-1989



Sources: Paul Kagan, Kagan Cable TV Financial Databook 74 (June 1988); Cable TV Advertising, April 27, 1988, at 3; Advertiser Syndicated Television Association, Guide to Advertiser Supported Syndication 16 (Supplement to Advertising Age (March 27, 1989)).

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS THERETO

Q. We heard that the key to controlling the media marketplace is control over programming. We therefore understand your incentive to have the FCC repeal the financial interest and syndication rules. But, you still have a prime time share of 65% to 70%. Doesn't this indicate that you still have market power in the acquisition of programming? Who else buys "prime time" type programming? How much?

A. First, to cite the combined audience share of the networks as a measure of "market power" in the program acquisition marketplace is inaccurate and misleading. No network has a prime time share of 65% to 70%, and no network has ever enjoyed such a share. Instead, the combined network share is split unevenly among the three networks, with each network's share of audience in prime time usually in the range of 15% to 25%.

Second, each of the networks compete vigorously with each other for audience, programming and advertising revenue. To lump together the individual shares of each network masks the fierce competition that takes place among them in every aspect of the television business.

Third, the average American home has 27 broadcast and cable channels available, and most of the over 50% of homes that are cabled have many more than that. There is no shortage of programming from non-network sources available to most homes.

Fourth, the fact that an aggregate national share of 65-70% is earned by the three commercial broadcast networks largely reflects the popularity and quality of the overall program schedules of each network. At the same time, audience shares for individual programs on a particular network vary widely. A "hit" program such as ROSEANNE or THE COSBY SHOW may attract a 40% share of the audience, while a less popular program may be viewed by less than 10% of the audience. Thus, audience share is a measure of popularity, rather than any indicator of "market power."

What _is_ relevant to "market power" in this context is the number and size of the firms that compete with each of the three networks individually for the purchase of entertainment programming, and whether the number of those competitors is increasing or decreasing. CBS's experience and analysis shows that there are many competitors (beyond the other two networks), and the number of these competitors is growing.

In fact, each of the three regulated television networks had less than an 18% share of the _first-run_ television entertainment programming acquisition market in 1988. (And, if the market for syndicated programming is included, each network's share is much lower.) This relatively low number certainly does not indicate that CBS has "market power."

The testimony before the Subcommittee documents in detail the emergence and growth of these competitors for first-run program product. Here are a few highlights that are already in the record:

- Fox now has a full-fledged fourth network and spent $100 million on original programming in 1988;
- Independent television stations have grown 400% since 1970, now total almost 400, and spent about $1 billion on first-run programming in 1988;
- There are expected to be 110 cable networks by 1990, more than 30 of these services now exceed 10 million subscribers, and the cable industry is estimated to have spent $1 billion on first-run programming in 1988.

There are almost daily announcements of the increasing power and competitive impact of alternative program services. To use one example, MOLLY DODD was once on NBC, but now is the property of the Lifetime Cable Network which has reportedly commissioned new episodes and taken a financial interest in the program. According to press reports, Lifetime has several other orginal program series in development. In the off-network syndicated program market, Lifetime has purchased exclusive rights to LA LAW, apparently paying over $200,000 per episode. Increasingly, new and apparently well-heeled competitors are entering the marketplace for prime-time type programming.

Finally, we should not forget that the major studios have their own video distribution interests that are ready customers for their television programming. Four studios own cable networks; five own interests in television stations; and Fox, of course, has its own television network. These large companies are increasingly combining production and distribution because they perceive that to be the efficient way to run their businesses, yet they desperately persist in trying to deny CBS, ABC and NBC the same opportunities.

Q. Has the amount of revenues the networks receive from advertisers increased in the past few years?

Answer supplied separately.

Q. If the networks are permitted to own cable systems, what will prevent the networks from creating the two-tier system you discussed: one tier of high quality programming on cable and another tier of lower quality for over-the-air television?

A. Repeal of the network/cable crossownership rule would not in any way change our incentives to maintain the quality of the programming offered through the network/affiliate system. The foundation of free television is the network-affiliate relationship. CBS is committed to serve our affiliates which offer the most popular programming over-the-air and on cable systems across the country. CBS has supported repeal of the network-cable cross-ownership rule at the FCC because the primary purpose of the rule -- protection of an infant cable industry -- long ago ceased to be a serious concern.

Any threat of a two-tier system arises not from potential network ownership of cable systems but rather from the economics of cable versus free, over-the-air television. In particular, broadcasters provide a "subsidy" to cable operators through access at no charge to the most popular programs shown on over-the-air television. This subsidy results from the ability of cable operators to carry local broadcast signals without seeking permission or making payment, while the cable operator in turn charges its subscribers a substantial fee for delivering these broadcast signals.

The result of this sudsidy is not just that cable systems are becoming economically stronger and unjustly enriched. More signifcantly, cable's "free ride" is damaging over-the-air stations and broadcast networks through the loss of audience, programming and advertising revenues to cable. Cable is using these very funds gained at the expense of broadcasters to attract popular programming -- especially sports and entertainment -- away from free broadcasting and onto cable where it is available only to those able to afford increasingly more-expensive cable subscriber fees. The ultimate result could be a weakening of our historic system of free, universally-available television, to be replaced by a two-tier system of paid programming for the affluent and a lesser service for the remainder.

This changing economic relationship between broadcasters and cable also tends to undermine the goal of localism, where local broadcasters respond to each community's social, political, economic and cultural interests through news and public affairs programs. The overall popularity of our program offerings is directly related to its responsiveness to the needs and interests of the local communities in which network affiliates operate. The real threat of a two-tier system comes, of course, from many of our competitors who have no commitment to free, over-the-air service.

As a practical matter, no broadcast network could gain a national share of cable system ownership large enough to raise even a theoretical concern that the network would favor its cable system interests over its broadcast network and station interests. Indeed, recent estimates place the current value of the nation's cable systems in excess not only of the broadcast networks, but also that of the entire broadcast industry. In order for a network to acquire cable systems serving just 5% of the nation's households, it would have to spend almost $10 billion (at the conservative estimate of $2000 per subscriber), and it would still be only a fraction of the size of TCI, the largest multiple system cable operator.

Q. Since the FCC no longer requires broadcasters to submit financial data, it is difficult for us to analyze these issues. Could each of you provide the Subcommittee with a summary of your annual revenues and after-tax profits for your television network and your owned and operated stations for the years 1983-1988.

Revenues and profits should include all revenue sources during those years that are attributable to those entities, including foreign syndication of programming produced by your company.

State how those revenues and profits were allocated in those years between your television network and your owned stations.

For your owned stations, the revenue for sale of station time and the amount paid to the stations as compensation by the networks and the station expenses. Please include the station compensation paid by your network to sample affiliates in similar markets not owned by your company.

Answer supplied separately.

Q. Fox Broadcasting is proposing to establish a cooperative for children's programming. Do you believe that the cooperative's programming should be included in determining whether Fox is a "network?"

A. CBS believes that Fox Broadcasting's "cooperative" for children's programming should certainly be included in determining whether it has reached the benchmark established by the FCC to be considered a "network." According to press reports, Fox's so-called "Kid's Network" will be "financed, managed, promoted and sold by Fox." Since Fox appears to be exercising the prerogatives of ownership and control, it cannot be allowed to escape the consequences of its actions.

As the Subcommittee is aware, FCC rules define "network" for the purposes of the financial interest, syndication and prime time access rules as "any person, entity or corporation which offers an interconnected program service on a regular basis for 15 or more hours per week to at least 25 affiliated television licensees in 10 or more states; and/or any person, entity or corporation controlling, controlled by or under common control with such person, entity or corporation." It is interesting to note that, according to Fox's testimony before the Subcommittee, the 15-hour threshold could be reached as early as September 1990 -- when programming planned to be provided by the "cooperative" to Fox affiliates is counted along with previously announced Fox network programming.

CBS strongly believes that the financial interest and syndication rules are unwarranted, counterproductive and anachronistic. However, we just as strongly believe that special relief from those rules, along with the prime time access rule, for Fox alone is not worthy of serious consideration. Indeed, Fox has been a leading supporter of the financial interest and syndication rules through its membership in the Motion Picture Association of America (MPAA). The irony of Fox's pleas to be the only network unshackled by these rules is that they clearly refute Hollywood's argument that the rules are not burdensome to network operations.

Q. Do you believe that the Commission should retain its policies designed to promote minority ownership?

A. Yes, we believe that the FCC should retain its present policies -- tax certificates, minority preferences in intital licensing and distress sales -- which are designed to promote minority ownership.

Q. Your companies are now permitted to own 12 TV, 12 AM and 12 FM stations. Are any of you seeking to buy more stations? What are the efficiencies of owning stations throughout the U.S.?

A. CBS now owns five television stations and 20 radio stations (12 FM and 8 AM). We are committed to the business of free over-the-air broadcasting and are interested in acquiring additional broadcast stations on the right terms.

Group ownership of broadcast stations creates economic efficiencies, and the FCC has found that it is also correlated with increased commitments to local news and public affairs programming. The efficiencies of group station ownership include, for example, the ability to combine resources to support original program production, both in-house and outside-supplied, and to facilitate greater coverage of news events and issues of local significance which occur in remote locations.

In its 1984 Report and Order adopting the 12-12-12 rules, the Commission cited information in the record of the proceeding to the effect that network and group-owned television stations devoted more time to nonentertainment programming than non-group-owned stations. The Commission stated that these "differences between independent and group-owned stations' programming are important...," and concluded on the basis of the overall record of that proceeding that "[g]roup owners may be able to devote more resources to newsgathering and other activities which improve the quality of programming presented."

Q. Do any of your companies own 2 broadcasting stations in the same market? If so, do those stations carry more news and public affairs programming than a single station that you own in another market?

A. CBS owns two (or more) broadcast stations in several locations:

- CBS owns a television station and two radio stations (AM & FM) in New York, Los Angeles, Chicago and Philadelphia.
- CBS owns two radio stations (AM & FM) in Detroit, San Francisco, St. Louis, and Tampa-St. Petersburg.
- CBS owns a single (FM) radio station in Boston, Dallas, Houston and Washington, D.C. and a television station in Miami.

With regard to television, there may be slight differences in the amount of local news from station to station. As to radio, our experience is that the amount of news and public affairs programming on a station relates to factors such as size of market, format, whether the station is an AM or FM facility, and the competitive situation in a particular market rather than whether two or more stations in a market are under common ownership.

Q. What siginificance is there in the Time/Warner/ Paramount situation for the financial interest debate?

A. Time/Warner/Paramount demonstrates again how the competitive situation around the world is rapidly changing and new relationships are being forged for the future -- all with the three American networks largely on the sidelines because of American rules and regulations. More specifically, Time, Warner and Paramount, although they are already large, diversified companies, perceive that they need to combine to be better able to compete on a worldwide basis in video entertainment production and distribution. They apparently see growth in foreign markets as one of the keys to their future. On the other hand, the television networks individually cannot even structure flexible financing arrangements with major and smaller independent producers which provide for network participation in the rapidly expanding foreign syndication marketplace.

Time and Warner explained their original merger proposal as being driven by a need to compete in what is becoming a global media marketplace increasingly dominated by foreign-owned conglomerates. The point is that the concerns that prompted the Time/Warner merger are widespread among media enterprises, and they are prompting new business arrangements throughout the media marketplace that are not available to CBS, ABC and NBC alone. In this sense, the

Time/Warner/Paramount situation simply serves to dramatize the unfair regulatory predicament in which the American television networks find themselves.

Time, Warner and Paramount also perceive that they need the flexibility to combine and expand production and distribution of video entertainment product in order to remain competitive into the next century. By contrast, the television networks are limited by outdated restrictions that limit their production of programming; forbid them from acquiring syndication profit shares in network programming; prevent them from entering the domestic syndication business themselves (even as to programming they produce); and bar them from owning cable distribution systems.

It is ironic, of course, that Warner and Paramount continue to support these restrictions that deny to CBS, ABC and NBC the flexibility that Hollywood claims is required for its own competitiveness.

Senator **Inouye**. I thank you very much, Mr. Tisch.

I am certain that witnesses following you will vigorously argue against the elimination of the financial interest and syndication rules. I see Mr. Valenti getting ready there. And I am also certain that witnesses will argue that if these rules were eliminated, the networks would control the release of successful prime time programs into the syndication market; that if they were eliminated, you would favor your affiliates at the expense of independent stations or otherwise limit the ability of independents to obtain good programs.

How would you respond to these charges?

Mr. **Murphy**. Well, Mr. Chairman, what we are asking for is not the right to—at least at this stage—to be actively involved in selling off the network shows that we have an interest in in the syndication market. We want to have an interest in it, but other people would be selling it at that time. And I am sure that there can be ample ways to protect against us favoring our affiliates. We would have other partners in the deal, if we had a joint deal with someone else, a studio or an independent producer, and we would have an obligation to go for the highest price we could get, regardless of whether it was an affiliate, or one of the competitors, or an independent station. So I do not see that as being a serious problem that cannot be overcome by sensible regulations.

Senator **Inouye**. You would not favor your affiliates?

Mr. **Murphy**. No, I would not favor my affiliates. We have a relationship with them. We pay them for actually carrying our shows, as you know, with affiliate compensation; but I would not favor our affiliates at all. I would see no reason to do that. I would have an obligation to my other partner, if I had a joint deal with someone, to get the highest price. And I would certainly not favor the affiliate.

Senator **Inouye**. Mr. Wright.

Mr. **Wright**. Mr. Chairman, it is interesting, that issue was looked at some years ago, and there was a conclusion reached at the time that economic considerations made favoring affiliates highly unlikely, and there was no evidence even in the 1960s when networks did have opportunities to participate in the syndication business that they used that in any way to favor their affiliates or to withhold programming from the market.

I think that the economics of the business always have been that you have to derive the maximum amount of return on a program. An unsuccessful program, unfortunately, has no syndication value, and a successful program, then, becomes something that gets you through a long period of bad choices, if you will.

And I think that independent stations, by and large, have substantially more inventory needs than affiliated stations, because they have the benefit of the network programming. So when it comes to bidding and it comes to economic interest in having successful syndicated shows, the independent stations will always continue to be the highest bidders in the marketplace. Probably, though, going forward it may be that cable systems will be the higher bidders.

Affiliated stations from time to time show a lot of interest in off-network syndicated shows, but it is a limited amount of time that they have, because they have their news commitments, and they have all the programming supplied by the network. So if we were to take a position that we were trying to withhold programming, if we had that right, we would do so at an enormous economic cost, and it just would not make any sense, because the real interest out there is in independent stations and the cable marketplace for the vast majority of syndicated programs.

Senator INOUYE. Mr. Tisch.

Mr. TISCH. All we ask is that Congress set up a level playing field to protect the independent stations, protect the affiliate stations, but give the networks a chance to participate in the future of this industry.

Senator INOUYE. Well, I hope that the negotiations or the discussions that are now going on will continue, hopefully with some resolution; because if I were in your position, I would hate to have the Congress make the rules.

Mr. TISCH. We have a lot of faith in the Congress.

Mr. MURPHY. We would prefer to do it with discussion, though, Mr. Chairman.

Mr. WRIGHT. We could not be any worse off than we were. I will take my chances.

Senator INOUYE. I have other questions, but I will submit them. I have just one request. Today, the FCC does not require the networks to submit financial data. It would be extremely helpful to the subcommittee in coming forth with some recommendation to be able to analyze your financial data, profit margins to income, et cetera, for you and your affiliates. If you can provide these, we would appreciate it very much, sir.

Mr. TISCH. Just speaking for CBS, we would be glad to submit all the financial data. I do not think we have available to us the financial data from our affiliates. We do not get that from them. I think if Congress wanted that, they would have to ask the affiliates separately.

Senator INOUYE. All right, fine, sir.

Mr. MURPHY. I would certainly be glad to submit the ABC figures to you, Mr. Chairman, on the promise that you will not send them to Wall Street.

It is a matter of public record that ABC—we have been in the business three years, three full years, and the ABC network lost $70 million the first year we ran it; it made $70 million the second year we ran it; and we lost $5 million last year. There were figures submitted that we were going to make $178 million last year, but they were accounting decisions that had nothing to do with the cash. The actual figure was a $5 million loss. And we hope to make money this year, though.

Senator INOUYE. If it is possible, we would like to have it for the last five years, because we would like to see if any effect was felt from the 1984 Cable Act.

Mr. MURPHY. I would be delighted to submit it, Mr. Chairman.

Mr. TISCH. I could sum it up very simply, Mr. Chairman. In 1984 the CBS network earned over $300 million. In 1988 the CBS network earned $60 million. And it has been a slow erosion or steady erosion from 1984 through 1988.

Mr. Wright. Mr. Chairman, we are the beneficiary of whatever is left and we would be happy to do that. I would also respectfully ask the subcommittee to consider making the same request for the five major studios that produce and control most all of the programming that is in prime time today.

It is very hard to get their numbers, and my estimate is that their annual, domestic and international syndication annual revenues from essentially off-network production is about $3 billion. And that does not involve any investment. It is just simply sales cost, and so that figure is net of my estimate of selling cost.

That $3 billion, which is derived essentially by five studios, is something like four or five times greater than the total pretax profitability of the three networks you are looking at here. That is why when you say that Mr. Valenti will certainly be here, well of course the self-interest is enormous when you have five or six organizations that basically control those program libraries, and the syndication and foreign revenues from those libraries has just become incredibly attractive. So I would be happy to submit that information.

I would ask you to consider asking for similar information in a manner that would be easy to display from the major studios on their gross syndication revenues, both domestic and foreign.

Senator Inouye. We shall do so. Senator Hollings?

The Chairman. Thank you, Mr. Chairman.

The opportunity to be here and participate with three of the best business executives in the entire country impresses any politician. I hear a success story in a good part of the testimony and in fact the majority of the story, and yet there are some dangers that we have got to look out for.

As for the success, I can tell you you are not in trouble because Tom Murphy, he bought a bunch of stations and succeeded. He did not come to ABC Network as a failure. He came as a tremendous success and I wish I could buy some of that stock, but that crowd out there would criticize me. I do not worry a bit about you and the ABC stock.

There is Larry Tisch and he comes from helping us politicians to put in all those rules and regulations and he owns all the hotels—Metropolitan is a tremendous success—with the best of the best on Wall Street and you bought yourself a network voluntarily.

Mr. Wright has come from the cable industry back into the network industry. That fascinates me. GE got rid of light bulbs and bought the health business and network business and GE is not known to be a dumb industry. So I know the networks are doing well.

Mr. Tisch, right to the point, it is not a level playing field. The reasons for syndication and financial interest was to pare down the monopoly, to level it off for the public good. You had the studios, yes, making the films, but there was no market except from the three networks that had, as you indicated some years back, 95 percent of the audience.

Now the picture has changed, but how much? You are down to 70 percent. Any antitrust lawyer over at Justice would say that is still a monopoly, for three to have 70 percent of the market. Maybe not.

Mr. Wright, your testimony exemplifies the glowing success of the syndication and financial interest rules. We have all kinds of diversity with cable, and yet you state that a majority of those with cable are still watching the networks.

My question is, rather than the intramurals between you three and Hollywood, let us say we eliminate or relax the rules. Do we get better programming, more programs, cheaper programs? Mr. Murphy, what happens?

Let us assume that you convince us and we level off the field as Mr. Tisch suggests we do. Then what really happens? Do you really think you will get better programming?

I am reading about the programs on the hit list; that interest groups are telling your advertisers not to run any of their ads on. Substantial American interests with a hit list and Paul Simon's bill to get rid of the violence and the filth.

That is what America is really concerned about. Not really whether you make a profit. We are not worried about you folks. We know you are going to succeed. If you all moved on to other businesses, I would have a hearing to find out why. But you all have just moved in and so I am not worried about you making a profit, I am worried about the public end of this thing. Do I get better programming? Do I get more programs? Do I get cheaper programs? What happens?

Mr. MURPHY. Well, Mr. Chairman, I think that the proposal that Bob Wright and NBC made, which was to take the 22 hours of prime time and say, let 11 hours be just the way they are with the networks having no financial interest at all and have the other 11 hours available for either complete network ownership or financial interest deals on a partnership basis with the both the studios and the independent operators, gives us a hope of continuing to put on high quality programming for the American public in the future.

The CHAIRMAN. Better programming, you think?

Mr. MURPHY. Well, hopefully maintaining the kind that we have now.

The trouble with the business as I see it is you have got—it is an advertiser-supported business. The business has been fundamentally—when you take into account the Olympic cost, of the amount of money that we have to pay to the various Olympic Committees for the Olympics last year and the total advertising dollars the networks had in the last three years—has been virtually flat, where our costs are continuing to increase. So there is a squeeze on profits.

But everything we put on the air, we have—we put up virtually most of the money on the half-hours, a substantial majority of the money on the hours, and we get two runs and then it is gone. We build a hit over four years and then—we can only do it for four years and then the rules are such that the studios can put a gun to our head and have an open bidding on that show and they can take it to any one of the three networks or to Fox, for that matter.

In my opinion we are in a position where the overall three networks combined, the profitability, when you consider their invested capital, continues to shrink. Because of that we are fearful that we are going to be in a position where we are not going to be able to continue to put the kind of money and support the kind of quality programs we have been putting on prime time in years past, because the advertisers will not pay.

The cost per thousand continues to increase for our advertising and the size of the audience of the average spot that we sell has gone down and it is because of that reason that I think—I cannot guarantee you that modifying this will change the quality of the programming.

I think it will hopefully continue to maintain the kind of quality programming we have had in the past. Because we have certainly been trying to put the best programs on and even in the last three years, even though we have been under some kind of financial concerns at ABC Television Network, we have still poured the money into the product.

The CHAIRMAN. Mr. Tisch?

Mr. TISCH. Well, we sit here and we look like three friends and I guess we are three friends, socially, but I think we have to understand that the three networks compete furiously every day of the year to put on the best programming possible and to buy the best programming possible.

The CHAIRMAN. Now, that is an all-encompassing job. It keeps you full time as I understand it and if you had to also run a production studio, how would you have your mind and attention to do that?

Mr. TISCH. We would just compete for the talent the same way we compete for the programming. We all have experience in doing independent production. It has not been so successful at times.

But I think my main objective in this discussion with the Congress is to put really the question back to you, do you want to have a system ten years from today that encompasses free television for the American people?

Because we are gradually eroding the base of free television and at any point in time—it could have happened this year; politically it did not happen this year, but believe me, it was only political and at any point in time the cable systems can take away the World Series.

They have already taken partially away professional football, because if you are not a cable subscriber you do not get Sunday night professional football. The same thing can happen to the Olympics. Most likely in the 1992 Olympics half of the events will be available only to cable users.

This is happening already. It is happening in movies. We do not get off-theater movies directly to the American people. You only can get those if you are a cable subscriber.

So the erosion is taking place. Half the people in this country are not getting the best programming available and all we say is, by giving us an opportunity to compete we think we can prolong the life of free television.

It is your question more than ours. I see what is happening out there. I see it every day of the week. Maybe I am too close to it, but I see the erosion on a daily basis of what 50 percent of the American people receive over the air, and it is not a happy picture.

The CHAIRMAN. Mr. Wright?

Mr. WRIGHT. I would subscribe to some of those thoughts. I come to a hearing like this with a lot of data and a lot of information which is not particularly pertinent or interesting to you, but you are all intelligent people. You have very strong staffs. You have your eyes and ears to the country, to your constituents, to many other groups.

I come speaking for myself, looking for some sort of a sense of what you are happy with and what you are unhappy with and how interested are you—and I do not mean that sarcastically—in having a system which has been around for a lot of years continue.

Because to us the whole thing is incentive. The options are not complicated. Do we want this system, which has its failings and has its critics, to continue, or do we want to have a system that is much more niche-oriented and is, as was referred to earlier, basically a pay television system, where you pay for what you look at. The viewer selects and the advantage is, you do not have to watch anything that you do not like, you can simply find that which you do like and pay for it.

We are producers—very little on the entertainment side, but we produce a tremendous amount of news and sports. We do not make any money at that. The incentive—the reason we produce news and sports—is because of the historical obligation and other benefits we derive but we hope to actually make our money on the entertainment side.

To the extent that financial reward is not available to us or to others in the future, then the incentive goes to produce in mediums where you can make some money. This is not going to happen tomorrow afternoon. It is not going to happen in two or three years. But you just cannot deny what is happening out there. The question is, where are we going? Where do we want to go? What is the direction? Is there a public policy issue here, or maybe perhaps we have passed that and it is no longer a public policy question. It is a free market, and perhaps Americans are—they have already voted with their checks every month and they are perfectly happy to purchase programming. In that case, then NBC and others are going to have to look to those pay outlets.

So that is the issue. The system can stay the way it is if the networks can look to be involved in some meaningful way in the production of entertainment programming as an incentive to us to keep doing exactly what we are doing.

But over time the audience will vote, and without your involvement or our involvement, the gravitational pull is clear, where it is going. It is going right down what I call a pay television path.

Over 50 percent of NBC's audience today pays to watch NBC programming. That is kind of ironic because the Communications Act was designed to provide it free. But people have voted for other reasons and maybe someday it will be 70 percent or 80 percent.

The dollars that are generated by that pay system are enormous. The cable industry today has got a capitalization probably something close to $150 billion. I mean, we are not talking about what we used to talk about when I was in the business. There is a lot of money for cable programming.

So all the programming that we all want to see will eventually get on television, but it will be on television in a pay form. Perhaps that is not the worst objective, but I think it is one we ought to talk about and it is one that deserves the attention of this subcommittee and us and thoughtful people all over the country.

The CHAIRMAN. Well I think those are very thoughtful answers. I think you really pose the real question, Mr. Tisch, and you all three asked whether or not the basis of free television is being eroded. That is something this Committee is really concerned with and that is a moving target.

You talk about Sunday night football. ABC owns ESPN which carries sports programming. You fellows are hard to catch. I do not know how to put in a law and a policy that will hold tight, and maybe it should not hold tight, but this particular policy has held tight pretty well for 30 years and it has brought a tremendous diversity and a tremendous financial investment and tremendous leadership.

Thank you, Mr. Chairman.

Senator INOUYE. Thank you. Senator McCain?

Senator MCCAIN. Thank you, Mr. Chairman. Mr. Tisch, you struck a chord I think when you talked about a level playing field. As you know, the independent television people will be before this Committee as they have been in the past, and they are very concerned about the issue of warehousing.

What safeguards do you think may be necessary here if the rules under discussion were rolled back? What safeguards may be necessary to ensure that the marketing decision of when, if and to whom a program may be available for syndication is made in a nondiscriminatory way?

Mr. TISCH. Well, I think one way to do it is to have free, open bidding or free closed bidding, whichever the Congress decides would be better, but to make sure that in the bidding process which we go through today anyway for any program in any market, that the independents are treated fairly and I am sure that could be arranged.

Senator MCCAIN. The independents make an argument, Mr. Tisch, that you might just withhold one or more of these programs. No matter what they did, they would not be available.

Mr. TISCH. I do not think that could be done. I do not see how that would be done. We are still in business to make a profit. Why would we withhold a program if an independent is willing to pay a price higher than anybody else, or if an affiliate is willing to pay a higher price than anybody else? I do not think that is practical. I think you can put in a set of rules to make sure that the independent stations of America are treated fairly and we would be willing to abide by those rules 100 percent.

Senator MCCAIN. Mr. Wright, in Mr. Tisch's statement he makes a very, I think, compelling—or raises a very compelling question which probably is the source of major concern that many of us have.

He says, does it matter if major events such as the Super Bowl, World Series and Olympics move onto cable and are available only to affluent Americans who would pay handsomely for what all Americans now enjoy for free?

Is it not the fact that NBC is going to put at least part of the upcoming Olympics on cable television, or pay-per-viewing basis?

Mr. **Wright**. Yes, it is. It is a perfect example of what we are talking about. We think we have probably done the Herculean job of guaranteeing that the 1992 Olympics will be seen by all Americans for free to the extent that they watch NBC, in the same manner that they have always seen it.

But we could not afford the bid without trying to generate some additional revenue, so what we did is to construct a way to offer a different package on a pay-per-view basis. It will be arguably only purchased by a few, because it will be expensive, but it will not take away from the rest of the service. How long that can continue is very difficult to determine.

In the case of major league baseball, you saw the $400 million package of games that went to cable. We can bid and we do bid very aggressively, but you can only go so deep. You can only plan to lose so much money for prestige before you realize that you are jeopardizing the whole underpinnings of your business.

So in our case I think we saved the day for 1992 by concocting another method to try to bring in some income to justify the bid.

Senator **McCain**. Well, Mr. Wright, I think there is a different way of looking at that too and that is that this is the first step in moving more and more entertainment onto a pay-per-view basis and that perhaps in the 1996 Olympic case, because as Mr. Tisch mentioned you are in furious competition, that part of the bidding might be based on providing more and more or less and less of the Olympics to free, over-the-air viewers to cable subscribers and it is a matter of great concern in my view.

Mr. **Wright**. It is of concern to us. But you have to remember, we do not own the rights. We are at an auction. It is just like going to an art auction. You sit in the front row and they put a number up and you raise your hand or you do not. I mean, this is not very sophisticated. You either pay the money or you do not get the rights.

Senator **McCain**. I agree with that and therefore maybe there is an argument that could be made, if that is the case and you are inevitably driven to pay-for-view TV, that Congress should make sure that the American viewing public who are not affluent should be provided with a certain amount of viewing of the Olympics, then, if your argument follows through.

Mr. **Wright**. Well, I think that is definitely a public policy issue. Our position is we will do everything we possibly can economically to guarantee that, but there comes a point—it is not 1992, we have saved that one. Whether it is 1996 or not I do not know, but I think those are fair, responsible questions.

Senator **McCain**. Thank you. Mr. Murphy, in your statement you talked about the restraints that you would like to see lifted concerning production, and in your statement you say, "This is not to say when the limit on in-house production expires we would produce all or most of our own programming." How much would you envision that you would be doing?

Mr. **Murphy**. Well, as you know, everything is driven on getting the best shows and you have to do that with the best creative talent, and that means the writers and the producers and the actors and you would be doing, in my opinion, in the foreseeable future, obviously because we offered an opportunity to go 11 and 11, a minority of all of the shows in prime time.

Because the diversity of creative people that you would be doing business with—you would be doing business with not only major studios but the independent people—and they all certainly would not want to be doing business with just one network. So I would visualize for the foreseeable future that it would be a minority of the hours that would be available.

Senator McCain. Mr. Wright, in your statement you say the network business is now a money-losing or marginal proposition for two of the three networks.

There are some predictions made by Wall Street to the contrary, but I would not rely on those, but more important the issue is not who makes money, but whether keeping the free over-the-air broadcast systems strong is in the public interest.

How do you separate profit and loss from your ability to keep the over-the-air broadcast system strong and in the public interest?

Mr. Wright. Well, the things we always end up focusing in on at meetings like this, or hearings, are the entertainment shows because they are the ones that pay the bills to allow the rest of the services to go on and that is kind of unfortunate, because there are so many other things we do that do not have any real economic benefits in traditional terms.

But you end up saying well, what allows the system to go on is the fact that there is an opportunity to earn money on some forms of programming which you then spread around the entire system.

I think that the answer to your question is that the system will stay alive and healthy so long as people can enter the business on the theory that they are going to make a profit. When they conclude, and they may never, that they cannot make a profit, that all they have is a future of losses, they will not do it. That is the business equation.

The history of the business has been very good. Many people purchased licenses or obtained licenses or have won licenses with little or no cost. They have built up enormous fortunes, if you will. Most of those people have sold. Most of that has turned over.

Now you have the system in the hands of people who have debt and obligations and while the businesses are attractive at a distance they have the same concerns that other small business people do across the country. They have public service obligations, they have objectives, but they also have banks and credit and concerns about meeting payrolls the same as other people do.

They will stay at it. They will continue. There are a lot of people interested in this business, provided that they have some opportunity to think that five or six years down the path they are going to have an attractive financial return. They may not, but that hope is I think what keeps the system going.

Senator McCain. For all three of the witnesses, what are your plans as far as entering into the cable business? Mr. Wright.

Mr. Wright. Well, we have made many forays into cable. We are a programming company, and our interest is to be producing programming and offering it to audiences, and hopefully to earn some money along the way or to enhance some of our other activities.

Quite frankly, because of the regulatory limitations, we operate one over the air network, and the average home today has 27. There is an enormous outcry for programming on cable. And cable programming entities are more and more able to support that demand. So we have pursued it. We will provide programming to cable networks or help form cable networks as a way to get programming in front of viewers.

And that is part of the future that I cannot ignore. Because my little network box is a very limited one.

Senator McCain. Mr. Tisch.

Mr. Tisch. Well, I may go down in history as the Sewell Avery of the broadcasting business, but I am determined, as long as possible, to keep CBS as a pure broadcaster in free over-the-air television. How long we can do that I cannot say today. But I do not want to take our eye off the ball, take our executives' eye off the ball. We have all we can do to do a better job in over-the-air free television. And we are going to continue trying that.

I think, with the help of the Congress, we can continue doing that for a long time. If things change, if we cannot see a future in free television, then we will have to make a different decision.

Mr. Murphy. Senator, the main business that I have been in all my adult life has been in broadcasting, in over-the-air, free, advertiser-supported broadcasting. It is the bulk of all the business we do when you put our stations and our network together. And what I think all three of us have talked about today is absolutely vital to the future of over-the-air, advertiser-supported television.

Having said that, I have to tell you that the most attractive part of our business right now are the cable networks that we have financial interests in because it has two sources of income. We get some from the cable networks, which gets from their subscribers, and the rest we get from advertising.

All three cable networks that we have an interest in, Arts & Entertainment, which I think is about 37 or 38 percent, 33 percent in Lifetime, and 80 percent in ESPN, all made money last year and made, obviously, more money than the ABC Television Network.

So if we had a chance to continue to grow in that area, I would do exactly what Bob Wright was talking about if I could. We looked at things like the Financial News Network and things like that; we were not able to make a deal. But, you know, we are a public company and I have obligations to my shareholders, so I would be interested in that area.

Having said that, in my opinion, the long-term best interest, not only of this company, but I think of the American people, is to get a level playing field for the three networks so that we have a chance, as Bob Wright says, to make some money and have an incentive to make some money, rather than putting up most of the money and having two shots at a program and then it is gone forever. The economics just do not make sense in the business.

It is structured improperly for incentives because of the rules that were put in, perhaps correctly, when the networks had so much power.

Senator McCain. Thank you all very much. Thank you, Mr. Chairman.

Senator Inouye. Senator Breaux.

Senator **Breaux**. Thank you very much, Mr. Chairman. And I thank all of our distinguished members of this panel for being here and their testimony on the subject.

I was looking at some of the testimony from the next panel. And I note that Mr. Valenti, in a rather subdued statement, says, "So we glimpse a scene out of Oliver Twist, the three networks in baggy clothes living among the homeless, tin cups in their caloused and scrawny fingers, crying out for more gruel, more gruel. Frankly, to paraphrase Lord Macauley, there is no spectacle so ridiculous as the three networks in one of their periodic fits of desolating poverty."

But, before he said that, he pointed out that he was quoting from the Broadcast Magazine about their report in 1988, looking at network and owned and operated television station operations, pointing out that NBC piled up a profit of $537 million, ABC a profit of $595 million, and CBS a profit of $195 million. And that compares with what I think Mr. Wright tried to point in his opening statement that the reason why these changes should be necessary is because—you termed it as the networks are now being shackled by economic regulation.

And that really is the question. I mean, from one perspective the profits are immense, and from the other perspective, yours, you are being shackled by economic regulation.

Now, we are trying to figure out which one is right. At least that is where I am coming from at this point.

Can anybody help me on this?

Mr. **Murphy**. I would like to just comment on something if I could. Those figures are not completely accurate as far as ABC is concerned. I have seen the figures. And Broadcasting did comment because of a technical accounting change that had to be made because of financial accounting principles, that the ABC Network made $178 million; is that what the figure says, Senator, there?

Senator **Breaux**. I think I said—this was quoted as $195 million.

Mr. **Murphy**. $195 million then, according to Broadcasting. In fact the ABC Television Network lost about $5 million last year, and I said I would be glad to submit those figures to you. Those other operations you see are either the stations that we own, all of which we bought, or newspapers or our cable operation or our publishing operation, which are other parts of our business. I think that all parts of any business, if you are a businessman, you want to have every operation stand on its own bottom if it can, so I think it is important.

And conversely, I would just like to say if I could, everyone talks about the stock. Chairman Hollings commented about how well we were doing, and I am not apologizing for it, Senator. But if you look at how well the major production companies in Hollywood have done over the past 6 months, 12 months, or 18 months, and I would be glad to submit to the committee if you would like it, their stock has gone up at the same percentage rate on the average as either CBS, General Electric or Capital Cities/ABC.

Senator **Breaux**. But can the argument be made maybe, Mr. Wright, that when you look at these numbers, and I think Mr. Murphy would argue we have to look at each entity separately, and some are doing fine and some are losing, but when you look at the total picture of each one of the corporate structures that you run very, very well, there are some very big profit numbers there.

But the argument I am hearing, that somehow it is still being shackled by this economic regulation, and is it not fair to look at the total picture for each one of the networks and see their total income and whether you are being hampered or in fact are doing very well with the current system?

Mr. WRIGHT. No, I think that is fair. I do not have a complaint. We have an ironic situation where we do very well at NBC. So, in some respects I am more credible than the others. I am not pleading poverty. We are doing very well. It is a kind of a strange, bizarre situation. I have never been in a business where one company does as disproportionately well versus the others. It is a funny time, one that has not happened in the broadcasting industry in the past at the network level.

So, I am not apologizing or saying that NBC is losing money. But the fact is that the network system itself is a very bizarre one, and it is one under a tremendous amount of economic pressure with marketplace changes. And it is not fundamentally a sound system. And it is why, I think, one of the reasons—I mean, I cannot speak for my competitors over here, but it does not strike me that they have a very enviable situation at the present time. And it is not going to get a lot better.

Now, maybe they will take some of mine away, or whatever. But it is fair for you to ask that question, it is fair to look at it. But you have also got to recognize that the vast majority of the things that we put on the air that have an awful lot of appeal and are part of what we are do not have any economic return. And the amount of working capital in the business is enormous. I mean, networks are big businesses. We are like Kroger's, I mean, we turn over a lot of dollars to get to that profitability. And people have expected to see some sort of a return for that investment.

I think the margin in the business itself is about 4 percent. Now, our margins are a lot higher, Senator—at NBC. We are fortunate. Maybe next year they will not be so good, but the three network average is about 4 percent. And the network business used to be about a 10 percent business. And most businesses in this country are in the pre-tax profit margin range of 5 to 10 percent. And 4 percent is a big drop from 10 or 11, which it used to be; and it is not going up.

Mr. TISCH. Senator, I would like to put that in perspective. I can understand the differences between the three networks, but suppose we lumped the profit of the three networks together. And I would venture to say that in 1984, the three networks combined had a profit of about $800 million as networks. In 1988, the three networks combined had a profit of about $300 million.

Now, when we say $300 million of profit, that is a lot of money, but it is not a lot of money when one realizes that the three networks together have working capital invested in the networks of over $3 billion. And this is not including the studio facilities and everything else that goes into making a network.

So, as an economic business, this is not a good business at the present time.

Now, the three of us will survive. We are rich companies and we are determined to put the best programming possible on to the American people. And if we lost money at CBS, we will continue to do that. But at some point our stockholders may object to the program we are following. And it would not take much to get it changed in the entire industry at that point.

The three of us sitting here today are determined to maintain free television for the American people. I do not know who my successor will be or the successors in the other companies. At some point in the history of every business, economics take over. And the trend is the thing that worries me at the present time. If this trend continues, there will be changes to the detriment of free television.

Senator BREAUX. Just a final point. Mr. Tisch, you had pointed out, I guess, maybe alluding to it now, that if the changes are made, it may prolong the life of free television, a phrase that you used, which is disturbing in itself because you are talking about you are prolonging the life, but there is a death that is around the corner somewhere and it is just a question of how long we can prolong its existence.

Is that really what we are talking about here? Is that really the concern of free television?

Mr. TISCH. No, I think free television can last for the next 50 or 100 years if given a fair opportunity. If not given a fair opportunity, I cannot predict any life span, because we become self-destructive after a while. That is what bothers me. It is a very slippery slope. At some point CBS or ABC or NBC cannot afford to take a loss on baseball, or cannot afford to take a loss on the Olympics, or cannot afford to take the loss in sending our news division to China. We did not get anything economically to send 70 people to China to cover the revolution there. We do that because we think it is our public obligation.

At some point in the history of a business, you cannot afford to take these hits. That is what worries me about the future. And that is the slippery slope I do not want see free television to bargain down.

Mr. MURPHY. Senator, I think, just to add to that, that if these rules do not get changed sometime in the foreseeable future, the quality of the programming that the three networks will be able to put on and afford will deteriorate over a period of time. And I do not think that is in the best interest of the American public.

Senator BREAUX. Thank you, Mr. Chairman.

Senator INOUYE. Senator Gorton.

Senator GORTON. Thank you, Mr. Chairman.

Mr. Wright, you commented a few moments ago that you find hearings like this useful, among other reasons, because it gives you some insight into what this constituency, which has a considerable influence over your fate, is thinking and the directions in which it is going.

At the same time, all of you have quite properly emphasized that you have at least two other constituencies, your shareholders when you are looking at the bottom line, and perhaps most importantly of all, your audience that you wish to keep. And sometimes there is some conflicts among those three groups.

And I simply have to begin my remarks, Mr. Murphy, by saying that when you ask us to make drastic and controversial changes in the rules in order that you may maintain the quality of the programming you put on today, you create some considerable mountain for yourselves to climb, when many here think with great concern of the impact that so much of your programming has, particularly on children and on young people and on the general moral or ethical climate of the country.

Now, that is an emotional response, because it is doubtful that the quality of programming increases very much under another alternative system which you do not like. But while you are thinking about those impressions, you may think about that one, that when you say we have got to make all these changes in order to keep the same quality of programming, you are not advertising very strongly for the changes which you wish to have made.

I would like to pursue, and it comes from Mr. Tisch's testimony, but each of you can comment on it—Mr. Tisch, you asked four rhetorical questions in your oral testimony, and I find them here in your summary sheet, for which the short answers are fairly obvious, the long answers may not be so obvious.

I would like to go through one that you emphasized. You said does it matter if major events such as the Superbowl, World Series and Olympics move on to cable and are available only to affluent Americans who would pay handsomely for what all Americans now enjoy for free? I think I can assume that your answer is yes, it does matter.

The next question, however, is do you propose, in order to retain the Superbowl, the World Series and the Olympics on free television, some kind of restriction on bidding rights for those items? And do you propose that they will stay on free television if you are able to get income from the cable companies for what they get from you free now? What is it specifically that you propose in the way of changes that will assure us that these particular events will stay on free television?

Mr. Tisch. I think a number of things may be necessary in the future. One, is the level playing field so that we can survive economically as networks. Because in our bidding for baseball, we determine to take *x* number of dollar loss each year for four years at CBS.

Now, we can only do that because our overall situation is a healthy one and we can afford the loss. So, I think the first thing we need is the level playing field which maintains free television into the future.

The next step may require the interference of Congress. For instance, if cable, today, wanted the Superbowl, I do not think there is any way we could keep it. Because just take a simple number, say there are 50 million cable homes in America and you put it on a pay-per-view basis, and the cable company decided to charge $10 to watch the Superbowl. Well, I think half the people who have cable would subscribe for that $10. Therefore there would be an income of $250 million. And I do not think any free system can compete with a $250 million payment, in addition to which they would still get advertising revenue.

So it may take a combination of a lot of things to make sure that these major events and major programming in the future are available to the American public on a free basis.

Senator **Gorton**. I think that is a very candid answer, but I want to go through it once again. You are saying in order that a yes answer to this question be implemented, one, you need some change in these syndication rules so that you could operate your entertainment television at a greater profit in order to subsidize sports; that is number one.

Number two, you are going to need some ability to charge these profitable cable companies something for the privilege or the right to carry your network on cable.

And three, in addition to that, you are not sure, but you may need some kind of direct restriction against the bidding on certain events, at least, for anything other than free distribution.

Mr. **Tisch**. That is conceivable, yes. You may need all three.

Senator **Gorton**. Do either of the other two have any comments on that?

Mr. **Wright**. That is a hard one to answer. I think it is about incentives. When you said in your earlier remarks that there are elements of maintaining the current programming which are very unattractive as an objective, I think you have to look at all the things that we do. And you have to look at the fact that there are news programs and sports programs and public service and public interest programs that have value that is not economic value. They all get funded in one form or another by the successes.

Ironically, the economic successes are often the most controversial of the programs, and the ones that would split this room down the middle, in many cases, in terms of voting our interests. But that is the nature of the system that we have.

I do not know that it is practical. I do not know that a scheme can even be developed to do quite what you were just going through with Mr. Tisch, but I think that thought process should be there. If you walked out and said all right, fine, we will just implement elimination of the rules as proposed in 1983, and we will just stay out of this for five years, all we would really have is an opportunity to gamble more. And it does not assure anyone of success.

As studio people will tell you, just the fact that you can own a show does not mean you are going to make any money with it, you just may lose more.

But it gives you incentive. It gives you kind of a thought process to say hey, maybe if I learn this a little better I will do better, and that gives you the incentive to do something else that may, in the near term, not look like the greatest economic decision.

And I am sure that ABC and CBS, as we do, constantly make decisions that we know are not sound economically, in the hopes that some other element will be attractive.

Now, when you talk about something like these major events, there are other compelling aspects to them that control them somewhat. The organizers of the Olympics wants to be seen by every home. So we have a little bit of control. I am sure the NFL would find some very distasteful hearings here if all of a sudden they decided to take the Superbowl and put it on pay.

But those things are going to happen over time, and as we get into those times we ought to ask those questions and try to answer them.

I do not know whether we can sculpt an answer to that question that you asked: Can you have a rule? Can you limit bidding? Can you control it? It seems very difficult to do. But you can certainly try to hope that we are incentivized enough and we think we have an opportunity to be very active bidders for those kinds of things. And, in many cases, even bid more than we should; sort of get in much too deep under the theory that we can afford it because of some other element of our business.

That preserves the system. That keeps the overall system going. And maybe we will all learn a little bit more about the taste of the viewer and the economics of the business.

Senator GORTON. Thank you, Mr. Chairman.

Senator INOUYE. Senator Kerry.

Senator KERRY. Thank you, Mr. Chairman.

Mr. Tisch, in the absence of a financial interest rule, the assertion has been made that you folks would then be in a strong position to deal with the leverage that produces for access to programming. Is that not, in fact, true—that you would then, in the absence of the rule, have a much stronger capacity to be able to affect programming access? Is there any reason that that would not happen—that it would be marketplace controlled?

Mr. TISCH. Well, I do not think so. We are the ones who are wooing the talent. The talent is not wooing us. I mean, it would be interesting asked all three television networks to bring in their expense accounts, and asked the movie producers to do the same thing. See who is paying for the dinners.

We are the ones who are wooing the talent. We go after them to bring their product to us. And I think no matter what happened on financial interest, that system would still be there. That talent prevails.

Senator KERRY. But once you have the capacity to own the programming, so to speak, do you not change the playing field and the negotiating balance with that talent?

Mr. TISCH. I do not think so, because owning the program does not mean anything unless you have the talent to make a good program.

Senator KERRY. I agree. But you will then be able to pick and choose in a way that you cannot today, because you would have access to that prime-time slot for the total—for the vertical production process in a sense.

Mr. TISCH. But we have access to the prime-time slot today, and we still have the right to produce some of our own programming, which we are not doing.

Our mission is to put on the best possible program that we can find, whether it is ours, or one in which we have a financial interest, or one in which we have no financial interest—makes no difference to us.

The only thing that we looked at in viewing programming for the fall season is, what is the best possible program?

I do not think giving us a financial interest would make any difference as far as that is concerned.

Senator **Kerry**. Let me ask whoever would like to tackle this.

I think my colleague, Senator Breaux, went into some profits. I was not here at the time. I do not know what figures he put out, but Broadcast Magazine suggested, NBC, $280 million—this is for 1988. ABC, $178; CBS, $43 million.

Are those relatively ballpark accurate? Is there a huge divergence?

Mr. **Murphy**. They would have to speak for themselves, Senator. I did make a correction in that figure, in that the figure for ABC in 1988 was about a minus $5 million.

Senator **Kerry**. Okay.

Mr. **Murphy**. The ABC Television Network segment of it.

Senator **Kerry**. Well, we will wait to get those figures. Let me ask you this, though.

Each of these networks has a different owner than it did three years ago, and all of you purchased these networks knowing of the financial interest rules. I would find it hard to believe that each of you could not turn around and sell at an enormous profit, each of your networks today.

What is there that should compel us, given the whole concept of caveat emptor, that we were all taught—that you, as knowing buyers, came into this relationship, why should we suddenly upset it at this point in time? What compelling interest is there for the United States——

Mr. **Wright**. Well, let me try something on that. You have got to look at the situation the way we looked at it. First of all, there was a reason why the other three sold, and, you know, that's why they are not here. Maybe they had some concerns about what would happen. So they said, let some other group try this one.

The other piece is that when I looked at the situation, I was quite familiar with the regulatory scheme. What I found is a very unusual situation. I found that in 1980, after three years of examination, a Ferris Commission staff recommended abandoning the financial interest in syndication, as being unnecessary and not serving the purpose for which it was created and all that sort of thing.

And then in 1983, that opinion was basically adopted by another, new commission, and it was joined in by the FTC, the Department of Commerce and the Department of Justice. An enormously unusual situation, to have that group of government agencies all essentially recommend that a series of rules which had been in place for 10 or 12 years get dumped—not modified, but dumped entirely as being unnecessary and adjust against the public interest.

I also knew that we had a letter saying that in the very end, Congress had interceded and said, "Wait a second, we do not want to see those rules changed. We do not want you to implement that. We would like you to have some discussions with your friends from Hollywood about this and after those discussions, we will take into account the facts and concerns that were raised in those orders. But first of all, we would like to see a period of discussion, because the other side has raised a lot of valid points."

And so, it is not quite fair to suggest that we came in here knowing that this was a dead duck in the water. We came in here knowing that a lot of—I am going to say well-minded, intelligent staff people over a period of six years, looked at this situation and said, "These rules do not make any sense. Get rid of them." And then there was a moratorium that said, "Wait a second, we will hold that up. Have some negotiations."

So I did not come here with the view that it was all over. I came here with the view that logic would somehow prevail in a changing marketplace that I was very well acquainted with from my cable side, and that sooner or later we would be at a meeting like this, and sooner or later the escalation of cable penetration and audiences would have fair minded, reasonable people saying, "you know, those people were not so silly with that six years of study, and the rules probably do not make any sense, and let us move on to a different issue."

So, maybe I am an optimist. Maybe I am not a realist, or maybe I am naive, but that is part of the issue.

Senator **Kerry**. Let me follow up again on that. You talked about the trends and the optimism. I think that is a good answer and I understand. And I am not—you know, I have not fallen on any side of it yet, but I am trying to probe it.

You have gone from 90 percent, when the syndicated rules came in, down to 67 percent. And I guess your network, Mr. Wright, claims number one position, with, I think, about a 26 percent share, overall.

And if you take the four out of ten homes that have cable at that point, watching at that given time, it is probably higher in terms of those actually watching any given evening. But, assuming, I mean, 26 percent, there is not cable entity that can even match 5 percent, is there? Or 4 percent, or 3 percent at this point in time?

Mr. **Wright**. The numbers are in that range. The 26 percent, though, represents the actual share of people that are watching, rather than the rating.

Senator **Kerry**. Okay.

Mr. **Wright**. The percentage of total homes would be in the 16 percent range, if you will. And the share of homes watching would be 26 percent. But you are correct on the rest of it.

Senator **Kerry**. Now, from a cable perspective. And, again, I am trying to flush out a few issues here. But in your testimony, Mr. Tisch, you noted that much of cable television's current prosperity is based on the subsidy extracted from broadcasters under the existing free compulsory license for cable, retransmission of network, and local broadcast signals.

Now, can the argument not be made that the fees charged by cable operators, are not really for the programming that they offer, but for the basic infrastructure which they have had to put into place in order to reach those homes? And that, in fact—and I think you suggested this later in your testimony, that actually broadens your exposure?

Mr. **Tisch**. I like the economic premise you just stated. I think the fees are based on what the market will allow. I mean, if you look at this thing, realistically, three years ago a cable connection sold for $800. Today, they are going for $2,800. What is the difference? The difference is the power of monopoly.

You have a situation where a cable fellow could come in, buy a local town, and raise the rates to anything he pleases. That ability has allowed the market price for cable to go from $800 to $2,800 in a period of three to four years.

And they are doing that with our programming, representing more than half of what the audience is viewing on their cable system.

Senator KERRY. I am aware of that. In fact, we explored that with Mr. Mooney yesterday, and I agree with you, there is something unexplainable in that level.

Mr. TISCH. Well, it is explainable.

Senator KERRY. Some do not want to acknowledge the rationale, the explanations, but it is explainable.

You have all talked and based your argument on the notion of this decline continuing, et cetera. Is there any way to demonstrate—is there any trend line that is predictable with any analytical basis, so we can rely on it, so that it shows where, in fact, it will be, or is this subjective?

And based on the past three years only, and conjecture as to where it is going?

Mr. MURPHY. It will continue to decline. The network share of the total audience will continue to decline, because the American people are going to have more and more choices, as more and more homes get connected with cable. As the day follows the night, that will happen, Senator.

Senator KERRY. Now, do I understand the rules correctly, in terms of the financial interest, that in the limitation as to your programming ownership rights, it is only as to the prime-time hours, which amounts to 22 hours per week.

So what we are really arguing about here is 22 hours of television time, because you have the ability to have the financial interest with respect to all the other programming hours, is that not correct?

Mr. MURPHY. No. There are limitations in the daytime too. They are not significant, or serious for most of the networks. ABC owns three soap operas. Our soap operas are on from 1:00 to 4:00, say, here in Washington, which is, I think, substantially more than any of the other two networks.

But the restrictions in that area, gradually, as years go on, have been loosened. And so I do not think it is a serious problem, but there are also, I think, restrictions late at night, too.

Senator KERRY. I need to check on that.

Mr. MURPHY. But the ones we are concerned with are prime time, Senator.

Mr. WRIGHT. I think the reason is that—and it has been that way, for some reason, for some years, is that the cream is in prime time from an economics standpoint, and the rest of the day parts are generally less attractive.

One of the elements, though, Senator, that we have not focused in on—and I know it is not our job to do that, and you will hear later from affiliates—is that there is a whole system here. And even though we may come or go as individuals, we are sort of trustees for a system of affiliates that we do not own and independent business people all over the country.

We own some of them in the sense that they are our stations, but the rest we do not. And there is all of that localism, which is unique to this country—I mean, no other country—you travel around—nobody else has a system like this. It is part of the issue that we represent.

If we were to disappear tomorrow, and you were to tell us, or suggest to us or others that there is simply no future in what we are doing, and we ought to take our whole national network service and deliver it to cable, that leaves an awful lot of people short and it changes a system. It fundamentally changes a whole system.

And I think in some respects, we are the proxies for that system. We represent more than we are entitled to when we come before you, because we are offering a single service, and then it is supplemented by 210 local affiliates, in the case of NBC. And that gets into it.

And the profitability that we earn from prime time, essentially, is what supports the rest of our programming.

As he said, we do not do much in daytime. We license almost everything we do. We have not had much success in that area. Perhaps we should try harder in terms of our own programming. But we have not had much success.

Senator **Kerry**. I think that is a good and important point.

Mr. Murphy, I just want to ask you one other question. What do you say to the argument made by people, based also on what you said in your testimony, where you say, "Studies have shown that even in the more than 50 percent of homes having cable television, and despite the wide range of choices that cable provides, a majority of viewing hours are devoted to the programs of the three national networks, and their affiliates."

How do you respond then to the arguments that are made that they are really broadening your exposure, and that, in fact, you are benefiting greatly, because you can turn to advertisers, and say, look, we have this much broader exposure. Therefore, that much capacity to increase revenue in advertising.

Mr. **Murphy**. Senator, most of the cable connections in this country now are because of the other services that the cable company supplies, besides the three networks.

Originally, when I was first in the business 35 years ago in Albany, New York, and I was mixed up with the Adirondacks and the Catskills, and the Berkshires, cable was just an extension of our signal, because someone put an antenna on top of a mountain and then put a cable down into people's homes. And that, indeed, was an extension.

But to get up close to 60 percent of this country connected with cable has to be—a lot of it is urban cable and people that could get the pictures from the signal coming out of the antenna of our various 210 affiliates.

The actual amount of audience that our three networks have is substantially higher in non-cable homes than it is in cable homes.

The point of what I mentioned there was just to show how attractive the programming that the three networks put on, and how vital it is to those cable companies to get them in a position where people are willing to hook up. And they, of course, do not pay any money, or they pay very little for it. I guess they pay some copyright fees for it.

And that is something that I guess that this committee is thinking of addressing.

Senator Kerry. Thank you very much, gentlemen. Thank you, Mr. Chairman.

Senator Inouye. Senator Gore.

Senator Gore. Thank you very much. Thank you, Mr. Chairman.

We had a hearing yesterday that focused on cable television and the concentration there. But first, let me add my words of welcome to those who have already heard, but let me focus on the cable issue as you see it, and then move on to some other subjects.

We heard testimony that some affiliates of your networks, long used to having—being recognized as Channel 4, or Channel 9, or Channel 7, or being moved into the Siberia of cableland, to Channel 51, or Channel whatever, because the programs that cable was more directly interested in—financially were being given those slots. And the network affiliates were being moved away from where viewers were used to watching them, toward lower-watched realms of the spectrum.

Have you had that, or are you familiar with that? Is that just starting? Is that an example of abuse?

Mr. Murphy. I will comment on that. I think any cable company that does that is crazy, because the popularity of the three networks is so good that the connection with the local channel, and with that channel on their cable franchise, makes all the sense in the world.

There was some of that going on, but I think it is—unless someone would care to correct me, that most of that has dissipated and it is not a serious problem.

Mr. Tisch. I think it works in the reverse in a way. They may let us stay where we are on over-the-air television, but they get paid to put somebody next to us, because that is the prime position.

Mr. Wright. I think that is probably accurate. I think it is one of those situations where there are no restrictions. I think that the subcommittee probably clearly understands that a cable operator, as far as I know, can move any of the signals anywhere. So you can sort of be forced to go Siberia, if you will. But adjacencies are important. And there probably is a lot of self interest in having programming in which the cable operator has an investment close to programming that is more actively viewed.

Senator Gore. Well, we heard testimony that no new programming has broken into the ranks of the top ten, or the most popular programs on cable, unless the cable MSOs had received an equity interest in it. Do you think that is an example of abuse?

Mr. Tisch. I do not know if it is abuse, but it is certainly happening.

Senator Gore. Mr. Murphy.

Mr. Murphy. Well, I do not know whether I know the details on that. I have certainly heard that there had been discussions along those lines, and particularly in bidding for new franchises, as to whether we should not be aligned with the big MSOs before we make a bid.

Senator Gore. Mr. Wright.

Mr. Wright. Well, I think the facts probably speak for themselves. I do not think in the last two or three years there has been any service lost that has not had substantial equity ownership by cable companies. It is a very competitive business. It is very hard to get on the systems.

Senator GORE. Well, is that not an example of an overconcentration of power, that the cable industry is able to wield over the programmers?

Mr. WRIGHT. Well, it is certainly an area that can be fraught with abuse. I mean, there is simply no question. The reality is that people are not running out launching new services on a standalone basis.

Senator GORE. Is it not very similar to what happened when—before the syndication rule, where networks required an equity interest in programming before it could get on the networks?

Mr. MURPHY. I was not in the network business when that happened. I was in the station business, but I was a distance away from it. I do understand that those were some of the reasons why, I guess, the rules were originally put in. And there certainly have been indications that there has been economic muscle used on some of these new cable franchises as they come along. But that is something for you to address.

Senator GORE. Mr. Tisch.

Mr. TISCH. I am not so sure your premise is right, Senator. I am not so sure that—and I was not there, so that is why say I am not sure that the broadcasters, the networks required a financial interest to put something on the air. I do not think that is so. But it may have been in some cases.

Senator GORE. Well, by 1968, 93 percent was network—

Mr. WRIGHT. That is not accurate, Senator.

Senator GORE. It is not?

Mr. WRIGHT. That is one of the "Jack Valentisms" that have been around a long time.

Senator GORE. I cannot believe that Mr. Valenti does not have an entirely accurate figure here.

Mr. WRIGHT. That comes out of an FCC analysis. You have to kind of read it carefully. What it was attempting to demonstrate—because it fooled me, too. Because I kept looking at NBC, and during that period of time I asked, what financial interests did we have?

We had an ownership share, as an example, and I will get back to that, in about—something between 25 and 30 percent of the primetime shows. And the ownership ranged about 25 percent on balance. And all during that period of discussion, from 1962 to 1968, the average annual income, if you will, operating income from all of that activity at NBC was $3 million a year.

CBS had more than that, I believe, and ABC, I think, had less. But it was a very, very small thing.

What the commission—what that particular number referred to was really that they were starting with 100 percent of programming, and then they subtracted the amount of programming that was advertiser-owned time—the networks use to sell program time directly to advertisers, who would have the shows prepackaged.

Senator GORE. Well, let us just——

Mr. WRIGHT. About 50 to 60 percent, I think, is the correct number.

Senator GORE. Let us just simplify this. Let us say you have got two programmers trying to get on the network, on your network, and you have a financial interest in one of them, and the other is independent. I mean, is that not going to——

Mr. WRIGHT. It has not. The fact of the matter is, we do that today. We are allowed to own programs. We have to produce them 100 percent. But what I cannot do is bring you in as a partner, at least not in the normal sense of the word.

But we do not make decisions on that basis, because the leverage in our business is all viewership, and you have to make decisions based upon prime time, which is the only place you have a chance to really do anything. You have to make decisions based upon the audience receptivity.

We did 14 pilots at NBC Productions this year. We have two shows going on the air. We had the worst record of any of the studios. You have to vote where you think the audience is going to be. You cannot vote on the the theory that you may make a dollar more, because the leverage is with the audience, not with who owns the show.

Mr. MURPHY. Senator, if we made a financial interest, we would put more money in. The so-called deficits of the show up front would be shared not only by the person who is producing it, but also by the network as well.

Senator GORE. Well, picking a hit, obviously, you are going to pick the hit, but that is a chancy proposition and if two shows are relatively equal and you have a financial interest in one of them and not in the other, obviously, you are going to go for the one in which you have a financial interest.

The syndication value depends upon the exposure in the first run, and that is why in the prior years the networks would demand an equity position as a condition of granting the access to prime time.

It is exactly the same thing that the cable industry is doing now in demanding an equity position in new programming that they introduce on the MSOs, and I think there is an irony in the fact that the networks are now feeling victimized by the power of a concentrated cable industry, just as the independent programmers felt the same injustice when the networks had it all to themselves.

Mr. Tisch, you are eager to comment.

Mr. TISCH. I am eager because there is one main difference. We are three networks in combat. We compete every day and every program.

The cable system is a monopoly. He can take an interest in a programming service, give him one of his 40 channels, and hope for the best. Nothing is going to change as far as he is concerned whether it is a success or a failure.

We just finished a month ago our programming meetings for the fall season. We did produce a few shows of our own that were in competition.

The first thing we said to our people, disregard completely the idea that we have an interest in those shows. We only want to make sure that we put on the air what is going to do best, and we have no interest in putting on something we own as against something that is supplied to us if the other one is going to do one-tenth of a share better.

Senator GORE. But in preparing the menu for your affiliates in giving them the choices from among which——

Mr. TISCH. We do not give them any choice. We do not give our affiliates any choice. They have no say, really, in our fall schedule. They do not see our pilots. We make the decision what is going on the air every September, and we say to ourselves that our programming, our ownership is absolutely zero consideration in the final decision.

Senator GORE. Now, you are an extremely successful businessman, and if you are confronted with two programs one of which can go into a particular slot in your network slot, you own one of them and you do not own the other. It is a little—I mean, you are a little uncertain about which one of them is going to have the most appeal to the public.

If you have to choose in an atmosphere of uncertainty, which is the typical case—after all you do not know which one is going to be a hit. I mean, you hire the brightest people who have that extra sense of what is going to sell, but a lot of these are close calls. Okay, you have to choose between program A and program B.

If they have an equal chance in your view of being a hit and one of them is going to make you a ton more money than the other one, as a businessman you are going to choose the one that makes you a ton more money, are you not?

Mr. TISCH. No.

Senator GORE. Oh, come on. Your stockholders are listening to this.

Mr. TISCH. Let me tell you what just happened on our own schedule.

The toughest spot in television today to compete against is Roseanne. What is that, Wednesday night at 9:00?

Mr. MURPHY. Tuesday.

Mr. TISCH. Tuesday night at 9:00. That is the toughest night, toughest spot. That is like the death spot.

Mr. MURPHY. Thursday at 8:00 is for me. That is Cosby.

Mr. TISCH. But today as far as we are concerned, the toughest spot is Tuesday at 9:00 against Roseanne.

We had a half a dozen marginal programs that we looked at, all the same, all terrible.

We decided to go with our own terrible program there because we knew the program did not have a chance.

You see, buying a——

Senator GORE. Is this an example designed to counter the hypothetical I offered?

Mr. TISCH. Yes, it does counter it.

Senator GORE. I do not think so.

Mr. TISCH. It does counter it because if we had a chance in any time slot, our own program, it makes no consideration whatsoever.

Senator GORE. Well, I mean, choosing between alternative sacrificial lambs is very different between trying to pick alternative cash cows. I mean, it is a different situation altogether.

Mr. TISCH. It is easy to make the decision on the cash cows.

Senator Gore. Let me just come back. Let us say you have two potential hits.

Mr. Wright. Can I take a shot at that?

Senator Gore. Say, one of them is going to make you a lot more money than the other one. You are not going to take that into account, Mr. Wright?

Mr. Wright. If it were exactly the way you described it, that would be correct, but it never is. The fact of the matter is that there is never equality balance or I have never seen it in our situation.

This is a relationship business. People come to you with their ideas, with their pilots, whether they be individuals like Steven Cannell, who is going to be here later, or major studios who have people under contract.

You deal with these people day in and day out, year after year. If you have two pilots that you think from an audience standpoint are relatively similar, which is the point you are trying to make, you now have to decide what all of the other consequences of that decision are.

That other pilot, which is no better in theory, may involve talent. It may involve producers, directors, writers, on-air talent to whom you have obligations you have inherited, or with whom you have a desire to do business in the future, or with whom you have relationships, or you have certain kinds of emotional, if not economic debts that cause you to make a decision that on the surface goes in the face of what you are trying to say. You cannot shake your head so easily. This is an emotional relationship business.

Senator Gore. I understand that, but I just think it is strange, with all due respect, and I have deep respect for all three of you. I just think it is with strained credulity to ask us to believe that you are going to ignore the fact that you make a lot of money.

The Senator from Montana pointed out yesterday that we do not allow—there is a law in Montana now allowing meat packers to own stockyards. I mean, it is the same sort of thing.

One final question, and I have gone over my time. I just want to express a concern that according to news reports, all three networks almost simultaneously eliminated their standards divisions, and there has been or at least have deeply cut the people and the attention paid to that, and there is a tremendous amount of concern in this country and I think is very justified about a dramatic change in the kind of programming shown in hours where young children are watching, and I do not think it is right, and I do not think that the networks are facing up to their corporate responsibility that goes beyond making money and runs to paying some attention to what the youngest children are seeing.

Mr. Murphy. Senator, I agree with what you say. I do not want you to think that we have discontinued that at all. We did downsize it like we downsized a lot of other aspects of the ABC network when we came in. We looked at it and we decided that they were overstaffed in some areas, but that operation is still very much in effect, and I am sure it is also in the other networks as well.

We have to protect and live up to our obligation as licensees to do a quality job and be concerned with that, how we treat the children in this country.

Mr. **Tisch**. If anything, we have raised the level of standards and practices and put it right under the president of CBS broadcasting. We agree with you on its importance.

We found when we arrived at CBS that a certain percentage of the people in this area of the business were put there with sort of a lateral arabesque. They had no job anyplace else in the company, and they were moved over to standards and practices as sort of a retirement home. Those are the people who we hope were eliminated, but the division, the area is stronger today than it has ever been.

Mr. **Wright**. We made a lot of changes. We reduced our——

Senator **Gore**. I noticed some of them.

Mr. **Wright**. I think that in fairness we went too far or we went a little far afield, and we have now had to create another organization or a new organization. Hopefully it will be better, or at least as good in all respects as what we had in the past, but it is an awkward area, and it deserves constant attention.

I would have thought that it would be easier to get more cooperation from both some of our own executives and producers, but in point of fact you do need a lot of diligence in this area, and we recognize that.

Senator **Inouye**. Senator Exon.

Senator **Exon**. Mr. Chairman, thank you very much.

Gentlemen, you have been on the stand a long time. We have other important panels coming along.

I have been listening with a keen interest, though, to the exchange that has gone on here, and the answers to the questions that have been put to you by the panel. I also like to come here because I continually learn.

I had never heard of this show Roseanne before.

Mr. **Murphy**. That is a disappointment, Senator.

Senator **Exon**. But then I did not until a few years ago when we had a hearing here in this room, I had never heard of the Twisted Sister.

So, you see, I come from a highly protected area.

I like to watch classical music, of which you do not have any. I like to watch anything with a ball in it, of which you have some, not enough. That is why I like cable. And, of course, I like news.

Let me try and take us beyond what we talked about here today. You naturally are driven under our free enterprise system by profit. The people from Hollywood are driven by profit.

You both deliver an outstanding product by and large, but I do want to echo the comments just made by Senator Gore. I do not think you pay enough attention to the quality of your products with regard to our younger citizens, but I suspect that that is not only because the networks are not doing that. The networks are driven, it seems to me more and more all the time to compete with cable, with cable television. You do not have that area of monopoly that you once had with the three networks.

I think we should be looking beyond all of this. Naturally, we here are representing our consumers. That is our job. We do not want to do anything to hurt the profitability of either the networks or Hollywood or cable, but I think over the years we have recognized the fact that we have some responsibilities here under federal law to protect our consumers and see that they are presented without monopoly and a free choice.

We have heard a great deal today about free over-the-air television, free television. Mr. Tisch said he was worried about the fact that the public today was not getting the best programming. I agree with that, Mr. Tisch. I suspect if we would get away from our present squabbles, as important as they are, and look down the road at the monopoly that I think is staring all of you in the face, that that is cable.

It was not many years ago that we assisted cable in getting going because we thought it was tremendously important that we expand the programming.

But, you know, last night when I was watching in my intellectual mode, watching the Reds play the Braves, and in Montgomery County where we have by far the worst cable television service anywhere in America, I suggest it went off the air. So, at least when I had free television, Mr. Tisch, I had more reliable service than I have now, but that brings home the point.

It seems to me that you in the broadcasting industry and you in Hollywood should be working together rather than at each others' throats. I suggest that with 54 percent of the homes in America today served by cable that means we do not have free TV, Mr. Tisch, for the most part.

Everything that I have seen or read indicates that in the next five to ten years that will likely go up to two thirds at least.

I guess what I am saying is looking beyond the present difficulties we have, as important as they are, do you not think it would be a good idea if we started working as legislators, as broadcasters, as Hollywood producers, to the proposition of making and breaking the monopoly that is obviously occurring today in cable television by insisting that at least in a certain area we have an option for the consumer to take that programming or this programming by the different television companies, so that when I sit in my home in Linoln, Nebraska, or when I sit in my condominium in Montgomery County I cannot have a choice rather than only one company which programs what I want to see or hope I want to see into my home?

Is that not a very long-term serious threat to free television, which I think is going by the board sooner or later? But is that not a threat to controlling what goes into our homes by one organization? Is that a concern?

Mr. TISCH. Yes, it is a concern, and I think I did say in my statement I think it is very important that the networks and the Hollywood community get together to provide the best programming possible.

We intend to negotiate with these people to try to achieve that result. We are only looking to the Congress as a last resort if the negotiations fail.

We think we can work it out, and we have been in discussion with some members of this committee on that issue. We think we can achieve it, but there has to be flexibility on both sides, and just because we live by a set of rules that have been in existence for the last 15 years while the world has changes does not mean that these rules should stay in existence for the next 15 years, and that is all we ask for is the flexibility to look at the rules as they now exist and see what can be done to help everybody get better television. That is our only desire in this whole case.

Senator EXON. Mr. Wright, let me ask you a question, since you come out of the cable television industry and have had a lot of experience there. I brought this matter up yesterday in questions that I asked of the panels that appeared then.

It is technically possible—I think it is very feasible—for us to have some kind of arrangement where in a city where you have more than one cable or in an area, say, of 50 miles where you have more than one cable television company, it would be possible for, through coordination, to give the consumer the choice as to what cable programming he wanted to take. That is technically feasible and possible, as I understand it, and if so, why would that not be a good idea?

Mr. WRIGHT. Are you talking about having two wires? is that what you are talking about?

Senator EXON. No, I am talking about one wire, just like we have one wire into my home today for telephone, but I can choose which long-distance company I want to use.

Mr. WRIGHT. Well, what you are proposing is some sort of a common carrier status for cable television operators, so that access to different programming services be on kind of a tariff basis, much like the wire into your house for telephone.

Well, the cable people are not going to be too thrilled about that.

Senator EXON. Well, I know they are not, but we are not here to thrill. We are not here to thrill the networks or Hollywood, and we are not here to thrill the cable operators.

What we are talking about is what is best for the consumer and what Mr. Tisch said was to give them the best possible programming.

Mr. WRIGHT. Well, the issue is on the table. I mean, that eventuality is not too far down the path. That will be the capability of most local telephone operators at some time in the next five or six years as they bring fiber to the house or coaxial to the house—the ability to have lots of different programs coming in.

I think the objective that you are getting at is clearly a reasonable one. Can it be accommodated with the current system through cajoling or do you need written guidelines to get there I think is the issue.

There are some systems that have a lot of capacity, and it is not too difficult to get on. There are others that have shortages of capacity and it is impossible to get on.

Now, is that fair? Should everybody have the same investment and have the same relative upgrading? I think probably there should be pressures to have all communities have relatively similar kinds of facilities, but then you have——

Senator EXON. And choices.

Mr. WRIGHT. Well, the facilities give you—I think the facilities give you the choices in any case.

Senator EXON. Thank you very much.

Gentlemen, I am not going to take the time to ask you this now, but I would like to ask this question and ask each of you to reply for the record if you would.

What significance is there in the Time-Warner-Paramount situation with regard to the financial interest debate? If you would respond for the record, I would appreciate it. Thank you, and thank you, Mr. Chairman.

Senator **Inouye**. Senator Pressler.

Senator **Pressler**. Thank you, Mr. Chairman. Many of the questions I have have been covered in your testimony or otherwise, but there is one area that is of great interest to smaller cities and rural areas such as South Dakota, and I might address this to each of the three of you.

In 1987 the networks said that in the process of scrambling, they were protecting their affiliates but that they would help the affiliates establish translator and low power TV to service areas not normally in the Grade A and B contours or, in other words, the harder to reach areas, the mountainous areas or something of that sort.

Can you provide me a report on how this project—on how this has gone forward?

Mr. **Murphy**. Let me comment on that because we are the good guys. We do not scramble, and ABC has not done that. Obviously, there is some pressure from our affiliates to do that, but I think we have been cooperating with the multiple distribution community antenna people in all areas where there are white areas to bring our signal to those areas without any excessive charge.

Mr. **Tisch**. We do scramble, but we do give descramblers in white areas so they can get our television.

Mr. **Wright**. I think we are probably the same as CBS. It is a very difficult issue for me because in theory the network does not want to have its signal scrambled. It wants people to see it. That is why we are in business.

The affiliates were very concerned. They put a lot of pressure on NBC because people were taking the signal and repackaging it and then selling it. Or they would bring in other signals into their community in violation of our agreement to provide one NBC signal. In Omaha, Nebraska, for example, somebody would be selling the Des Moines station. So, we went to—that is why we went to scrambling.

I have not heard much on the negative side of late because we have tried to make it clear that we want white areas to be covered by our signal because that is decidedly what we are all about. But if you want to further report on that, we certainly can get one.

Senator **Pressler**. Yes, I would appreciate for the record if we could have that for the record.

Let me ask. I am an original cosponsor of S. 177, which would reinstate the must-carry rule. Would you each give me your views on the need for the must-carry rule.

Mr. **Murphy**. Well, we have supported—our affiliates are very anxious to have it. As you know, it is more of a concern, as you know, for independent broadcasters in major markets to be on the must-carry, because practically every cable company in the country carries the three networks. So, we were not as concerned as our affiliates were. We have supported them in that position.

Mr. **Tisch**. The same as Mr. Murphy.

Mr. **Wright**. I think the same way. The must-carry and compulsory license have always had a long history of being somewhat hand in hand. And the fear, I think, that broadcasters have today is that if must-carry is no longer out there, why should there be a compulsory license for cable. It is sort of like half of a free market, and I think that has always been a concern, and it is a concern today.

Senator **Pressler**. Now, before the financial interest and syndication rules were introduced in 1970, the networks did not permit the distribution in syndication of shows that were still running in prime time.

If these rules were rescinded, would you return to that practice?

Mr. **Murphy**. Well, I would think that if we could get these rules rescinded, we would be able to handle that any way you like it, Senator.

Mr. **Wright**. I think we have probably passed the point in time where you could afford to do that. I think, again, it is the economics of the production side of the business that dictate having to take the hits when they do arrive and to maximize their exposure.

I think probably that sort of time has passed us, and my guess is that networks would have to continue with the current practice of other syndicators.

Senator **Pressler**. I might just ask in conclusion a question that—just to get your philosophy and your reaction. We all, I think, all Americans have sort of a romantic idea that attachment to TV, whether it is entertainment or news or what it is indeed we at one of our homes can only watch broadcast. We live about three blocks from the Capitol and we cannot get cable. I have said this in this committee before. We cannot put up a dish because the historic society prevents it. We cannot get the microwave because the Library of Congress building blocks the signal, and so we are locked into watching you.

Mr. **Wright**. We have to take that formula and bring it other places.

Senator **Pressler**. And there are 21 Senators in the same boat.

So, anyway, the cable industry, if you can rescue us, please do, but two of the networks, at least, are owned by large companies that do a lot of other businesses.

The day when witnesses appearing before the committee are actually the people owning it and running it is probably—there is probably only one of you in that category here.

Is there a danger to having a huge conglomerate buying and selling broadcast properties in terms of the public interest? All the corporate takeovers that have occurred are not very popular out in my part of the world, but they are occurring. What impact does that have on entertainment and just the quality of TV?

Mr. **Wright**. Well, I remember three years ago being asked similar questions when the NBC ownership transferred to GE, and I suggested at the time that size has its merits if there is enough light on the subject, because when times get tough, then size may allow you to get through it, and that was somewhat prophetic.

Now, in our case times have been good, so we have not had to test that theory as much. But certainly as an observation you have two other companies here whose viability to have stability in very tough times is, I think, accompanied by the fact that they have other business interests that are large enough they can that say well, we can afford to get through this difficult period.

I mean, there is a scale issue here that allows you to get through some difficult periods of time. I do not think there have been any negatives, and I certainly, as the one who would feel that in my company more than others, have not found that to be the case at all.

Mr. MURPHY. Senator, in our case I have been with the same company for 35 years, which is Capital Cities, and we started out with a UHF television in Albany, New York, and so we have already been broadcasters and broadcasters have run it.

I think we have already been conscious of our responsibilities through the FCC to the American public. I am certainly not aware that it is anything we have done as in purchasing things has caused any reduction in any of the quality of what we have done. Whether some other companies have been pressured because of heavy debt to change the kind of programming they do, I am not overly familiar with that having happened in the business.

It is obviously something that people occasionally bring up when they see these licenses being transferred as quickly as they have been.

Mr. TISCH. At CBS we are an independent broadcasting company. Today we have no other interests other than broadcasting, and I think as a viewer myself, and Mr. Paley, who is chairman of the company and the directors of the company that it is our aim to keep CBS as an independent broadcasting company for the future.

Senator PRESSLER. Thank you, Mr. Chairman.

Senator INOUYE. Thank you very much, and our anchorman from Montana, Mr. Burns.

Senator BURNS. Thank you very much, Mr. Chairman, and again I want to thank you. I have just got a couple of questions.

First of all, I admire wholeheartedly what you folks are trying to do, and that is to keep free broadcast out here. I happen to be a great fan of that. I might take issue on sometimes what you broadcast, but that is a free society that affords that, and so I understand that.

And I also wanted to—I was interested in what you said a while ago that the demand for your particular programming is very good for the simple reason I talked to a lady the other day. In fact, she is not the first lady that has unhooked from cable because she continually gets a double image on her set when you are broadcasting the channel you are broadcasting on is also the same channel on the cable. And so I can understand your power.

I wanted to ask Mr. Tisch, these little problems that we have that are cropping up now that are coming before this committee, can the industry along with the folks in cable and the folks in Hollywood and maybe your major sports franchise and Telco, the telephone company, can you get together and work out an agreement that is satisfactory to all of you before we start fiddling around with it here?

Because I get the distinct feeling if you let us fiddle around with it, we are not going to get it right.

Mr. **Tisch**. I cannot speak for all the constituencies you mentioned, but I do think that Hollywood and the broadcasting community and the three networks can get together. The others we have not had any conversations at all with, and I just do not know what would happen if we started to talk to them or what we would even talk about.

Senator **Burns**. I see an anxious look on your face, Mr. Murphy. Would you want to respond to that?

Mr. **Murphy**. I was just thinking. You know, we have got enough problems with Hollywood. I do not want to get mixed up with the telephone companies. We do not have a dog in that fight, and that is your game.

I have got enough enemies. I do not need that one.

I think that we should solve our problems. I would just like to make one comment, if I could, Senator.

The system that we have because of the restrictions that were set up probably justifiably 15 to 20 years ago put Hollywood and the networks at each other's throats. They come in and we can only have two runs and we are out. And so they end up, to put a good show on, to get it so that it does well enough so they can eventually get in syndication and hopefully get the pot of gold, doing some deficit financing, particularly the hour shows.

And the other restriction is that we cannot make a deal with any producer that lasts more than four years. So that after four years after a show like Roseanne or Cosby or Who's the Boss or Murder She Wrote has four years, and that is as long as the contract can be and then it is open season again, and Hollywood is forced to get the maximum amount of money, and so they put the gun to our head.

If we were partners together from the beginning where we would equally deficit finance, the problems on half hours and hours, then we would be partners in the rest of the game, too. That is just the right way, in my opinion, for a supplier and a buyer to do business, and it is the normal way to do business, and that is what we would really like to fix, in my opinion.

And I think that is in the long-term best interest of the American society.

Senator **Burns**. I just have a couple of other questions. Over the past four years the cable industry has moved more and more towards vertically integrating into programming, and I also understand first run syndication is beginning to emerge.

Given this trend, what percentage of programming is now being purchased by the networks as opposed to other distribution mediums like cable and independent television stations?

Mr. **Murphy**. Most of it is still being produced. The substantial big shows are all being produced for the networks. There are some off-network things like Molly Dodd is being produced for Life/time and things like that, and most of the syndication shows, the shows that the independent stations are buying are off-network shows that have been successful.

But gradually there is some trend towards some original programming at some of the cable networks. I do not know whether anyone would disagree with that.

Mr. **Wright**. No, I think that is accurate. There are all sorts of nontraditional sources of programming, though, we do not focus in on them very much.

There are many foundations that support an awful lot of programming that appears on television whether it appears on The Discovery Channel or public public television. A lot of PBS-originated/supported programming now appears on cable, on the Arts and cable network Entertainment and others. A lot of European television is also appearing, and so it is a little harder to generalize.

The shows that receive the most public attention are generally produced for broadcast, but there is an awful lot of other film and tape shows being done that just do not receive that much attention.

Senator **Burns**. As a follow-up, how much do the networks as opposed to the cable or independent television spend on programming. Is there a competition among you three for programming?

Mr. **Tisch**. There is real competition amongst us three, but I think in total the three networks spend over $3 billion a year on programming.

Mr. **Murphy**. And there certainly is competition, Senator.

Senator **Burns**. We want to make sure there is a lot of that.

Now, I just wrote down a comment here because it seems like this whole thing started kind of when the Yankees signed with cable and people got excited about are we going to lose our ball games.

And I am sort of like Senator Exon. I watch anything that has got a ball in it.

Could some of this concern—and I will just throw this out for your comment, and you may just want to pass up the whole thing and I would not blame you if you would. Some of the concern is the sports franchises are exempt from antitrust. Could this be the basis of some uneasiness among consumers and, yes, and I think we as a political forum here we respond more to the needs of the consumers. We respond more quickly and with more urgency than we would to, say, a single entity business. But is that sort of the basis of some of this?

Mr. **Tisch**. I do not know. In New York City, for instance, on the Yankees, the Yankees were carried by an independent station in New York for many years, not a network affiliate station, and what they did was, they put it out for bid and I gather the cable systems bid much higher or could afford to pay much more because they have two sources of income than the independent station could pay.

Mr. **Murphy**. And they are gradually going to reduce the number that are on Channel 9 in New York and have more of it on cable. But I think most of it will be on basic cable rather than on pay cable.

The problem—I cannot address the antitrust problem you mentioned, Senator, but I think it would be important for everyone to know that the decisions on whether sports shows have gone to the networks or have also opened up operations in cable are 100 percent decisions made by the sports organizations.

The cable companies like ESPN that we happen to own and Chairman Hollings mentioned that earlier, we bid on the NFL football on Sunday night because it became available by Pete Rozelle and the NFL, and it is the same thing with Peter Ueberoth and the baseball which will go on next on cable. It was strictly because they said we are going to put this up for offering, and we had to bid against USA Network and we had to bid against Ted Turner, and taking him on is a very interesting problem. He is quite a competitor. And so I think that most of the things—and I think Bob Wright said it earlier—most of the decisions based upon the sports operations are driven by the finances of it.

I do think that the major things like the Olympics and the NFL SuperBowl and the World Series for the foreseeable future will probably be on over-the-air advertiser supported free television.

But there is going to be a continual crowding, for instance, even on ESPN we used to have the NHL hockey and we lost the bid because it went off basic cable which was ESPN and went on pay cable because they offered $50 million, when I think we offered $32 million. We doubled the price we offered and we still lost it to pay cable.

So, it is strictly a matter of money.

Senator Burns. Well, I want to thank you. It is nearing noon, and obviously I have never missed a meal, and I do not plan to.

Thank you very much, Mr. Chairman.

Senator McCain. Could I ask the indulgence of the Chairman for one comment while we have these three very important and obviously very patient witnesses here?

We appreciate very much you being here. This has been talked about peripherally during this hearing.

I would like to bring to your attention a poll that was taken on the 1st of June for Time and CNN. The question asked was: "Do you think teenage violence is a bigger problem today than it was in the past or hasn't changed much?"

Eighty-percent percent of the American people think that teenage violence is a bigger problem today. Ten percent say less.

The next question is, "Which of these factors do you think are mainly to blame for the teenage violence we see today and which are not mainly to blame?" Too much sex and violence in movies—67 percent of the American people think is mainly to blame, 27 percent not mainly to blame.

Finally, "Which of these actions do you favor as a way to reduce teenage violence and which do you not favor?" One of the options was greater restraints on the showing of sex and violence on television. Seventy-three percent of the American people believe that there should be restraint, greater restraint on the showing of sex and violence on televison, 24 percent do not favor, nor do I think anyone on this committee is advocating censorship.

I think it is clear, not just from this poll but from everything I hear and everyone I talk to, that American parents, including this one, are deeply concerned about what is being displayed on television today, and it is not just network clearly. It is other forms and it is the independent television.

I think the American people clearly feel in overwhelming fashion that there is too much sex, there is too much violence. Obviously a large number of them think some restraint should be placed, and that may not be in your best interest.

I think it is in your best interest to review what is being shown and make sure the American people can turn this opinion around.

I thank you, Mr. Chairman.

Senator INOUYE. Thank you. Senator Hollings.

The CHAIRMAN. Just one last question relative to the broadcast licensing process being turned into an investors' game. We always had the antitrafficking provision. You would hold the license for three years at least so you could respond as all three of you have attested to, your public obligation that you were interested in broadcast.

Now, with the repeal of the antitrafficking provision, they are buying and selling within a year some 20-some stations last year. You just buy the station, buy the news staff, double up on the advertisements and get into clutter and turn it over to another unknowing investor and say look, this is a money-maker.

It seems to me that this new trend is going to break down free television and the public obligation for free television as much as anything else.

Do you favor the reinstitution, Mr. Wright, of the antitrafficking provision or not?

Mr. WRIGHT. I do not think I would oppose the reinstitution. I think you want people in there for the long haul.

The CHAIRMAN. Mr. Tisch.

Mr. TISCH. I really have not concentrated on that, Senator Hollings. We have not had that take place in our company or with any of our 210 affiliates, so it is really not an issue for us. I think it is an issue for the FCC.

Mr. MURPHY. I am on record, Senator, as supporting your position on that, and I am against this trafficking in our business.

And I have been in the business long enough that I object to it, and I have been on record in favor of an anti-trafficking rule and I think our record indicates that I have never sold anything except what the FCC forced me to sell.

And commenting on what someone said earlier, we were forced to sell our cable operations where we had 400,000 subscribers about four years ago when we made this deal. We sold them for $1,000 a connection, and now they are $2,800. So, something has been happening out there.

The CHAIRMAN. Well, very, very good, Mr. Chairman. I thank you. The witnesses have made a very impressive appearance here this morning.

Senator GORE. Could I ask one final question, Mr. Chairman.

We heard a charge yesterday, Mr. Wright, that NBC paid TCI, by far the most powerful entity in the cable in business, $20 million for an asset of limited value as part of its negotiation to get cable coverage of the new CNBC service.

Was that transaction demanded by TCI during those negotiations?

Mr. WRIGHT. Well, the name of the company is Tempo.

Senator GORE. It is just a shell company?

Mr. WRIGHT. Well, it had, arguably, 6 million subscribers. It was a service that we bought that had been round for eight years, and so it was not just created overnight.

We elected to change the service entirely. Hence the question about a shell company, I guess. But it was an existing service with six to seven million subscribers. TCI owned it. We did not. Purchasing Tempo was a way that we thought would give us the opportunity to start with six or seven million instead of going from zero.

Senator GORE. Was this kind of a shakedown by TCI to ensure that you would get access for CNBC?

Mr. WRIGHT. No, I cannot say that. We did not have to buy Tempo. We could have gone another route. We could have picked another service or we could have started up from scratch. It is hard to say what things are worth.

I notice that Warner is out there selling itself to Time, Inc. shareholders for $14 billion. Now, they are buying a record company, a film library and syndication business in television. Now, is that worth $14 billion?

Senator GORE. We do not want to get into that here, but did you agree not to compete directly with CNN in making CNBC a full-scale news operation in direct competition with CNN because TCI owns part of CNN's parent company? Was this part of the arrangement also that guaranteed you access for CNBC?

Mr. WRIGHT. We have a provision in our affiliation agreement that was requested, required if you will, by most cable operators that we not enter into general competition with CNN.

Senator GORE. Is that not anticompetitive?

Mr. WRIGHT. Well, it is not exactly what we would have preferred.

Senator GORE. Is it not anticompetitive?

Mr. WRIGHT. Well, it is hard to say. It is on the surface anticompetitive.

Senator GORE. Why is it hard to say? Because you do not want to offend TCI?

Mr. WRIGHT. Well, we certainly have to deal with our own customer base. That is our customer base.

Senator GORE. Well, you see, Mr. Chairman, this is an example of the kind of shakedown—and I use the word again—that cable engages in. And they just have the power and the arrogance to hold up one of the major networks and force them to agree not to compete and not to show news on cable television because the biggest MSO owns part of CNN and does not want the competition, and they just tell them, we will not even let you enter the market unless you agree not to compete.

And, by the way, we have this mostly worthless company that we are trying to unload on somebody. How about giving $20 million on the side for it.

Senator INOUYE. I believe most of us here are impressed by the awesome power of television, whether it be cable or free. But for those who are not, may I just ask them to ponder a few statistics.

There are more TV sets in residences, as Senator McCain has pointed out, than telephones or indoor plumbing. Statistics indicate to us that school students spend about five hours each day, five days a week in front of television and spend less than one hour on homework. While we are concerned about syndication and other problems here, I think we should keep in mind that because of this awesome power, all of us have a special responsibility and obligation to the people of the United States.

Gentlemen, I thank you very much, and I just do not know what words to use. This has been a unique opportunity for the subcommittee.

This is the first time in my memory I have seen the chief executives of the three networks sitting as a panel. The fact that we have spent nearly three hours, and the fact that 12 or 14 members of this subcommittee have participated should indicate to you not only the interest we have, but the high concern we have for what is now transpiring in the United States.

I believe I speak for all when I say that all of you have made compelling and convincing arguments on behalf of your industry, and all I can say is, Jack Valenti, you have got your work cut out for you. Thank you very much.

And now we have the second panel. Mr. Jack Valenti, President and Chief Executive Officer of the Motion Picture Association of America; Mr. Steve Cannell, Steve Cannell Productions of Hollywood; and Mr. James Kellner, President of Fox Broadcasting Company of Los Angeles.

Gentlemen, I thank you for your patience in waiting to appear before us, but I am certain you have noted the intense interest the subcommittee has in the subject matter before us. And so, without any further ado, may I call upon Mr. Valenti?

STATEMENT OF JACK VALENTI, PRESIDENT AND CEO, MOTION PICTURE ASSOCIATION OF AMERICA

Mr. Valenti. Thank you, Senator.

I listened with great interest to what was said in the previous three hours. In my reading, I remember the trial of Socrates. The trial went on for a long time with all of Socrates' accusers testifying, and finally they allowed him to come forward and present his case. He said, "my accusers have been so convincing, and so reasonable, and so persuasive that I almost believe them." And then he said, "However, scarce a word they said was true.

So I want to deal with what I think are the illusions that have been presented here today. At no time during the three hours that you heard did we address what I think is the central, core issue that leaps beyond a simple rule but goes to the public policy issues that attend the ideas, and the motivations, and the voting record of any Senator and Congressman in this Congress. And that is, what Americans know about news, and entertainment, and sports is preeminently borne to them through the television screen in their home. Therefore, in this free and loving land in which we live, our government ought never allow any tiny group of corporate chieftains or corporate entities, no matter how benignly managed, to ever reassert full dominion over prime time television, which is the most pervasive moral, social, political and cultural force in this country.

The networks' monopoly troika just cannot be allowed, no matter the blandishments they have given you, to reinsert, as once they had, full control over prime time television. If we do that, you are going to squeeze the life out of competition. There is a man here beside me who represents over 200 independent programmers who will tell you why that is so. What you will do is to turn sovereignty of the prime time air waves over to three chief executive officers.

I yield to no man in my affection, and warmth, and regard for Bob Wright, Larry Tisch, and Tom Murphy. Indeed, the highest accolade I could pay them is I would feel comfortable if they were the executors of my will, taking care of my family after I am gone. But I do not want them, or anybody else, taking charge of prime time television, which is exactly what would happen if this rule was collapsed.

By the way, you heard them grouse—and I think properly so—about the cable monopoly, and I have been known to speak a few words on that issue myself from time to time—and yet they come before you, in a strange piece of bewildering irony, and want you to honor them with the same kind of monopoly that they find so dangerous in cable. That is more than irony. And so I want to begin at the beginning.

When the FCC decided to look at the prime time television landscape, what they found, Senator, was a landscape soiled by a trimonopoly, and so, dismayed by and fearful of what they found, they decided to redirect their whole compass course toward an objective of competition in the marketplace. That is exactly what they did. They constructed the Financial Interest and Syndication Rule.

Simply stated, FISR says, first, you, Mr. Network, cannot extort a piece of the program owned by someone else as a price for getting it on the air. Some of the things that Senator Gore has said are so applicable to this. Number two, FISR said you cannot be in the syndication business, because you will run independents out of business.

Mr. Chairman, in the vast multitude of government rules and regulations, there are scattered among that maze a few that really do work. FISR is a rare regulation. It has done and is doing precisely what, in the public interest, it was created to do.

Because monopoly is endemic in cable, as it is in network prime time, the three networks are also barred from owning cable systems. Thank God for that, because if they were not, they would assert their fiscal authority in such a way that literally three people would have complete authority over what is seen in homes, either wired by cable or over the air, a monopoly in television never before comprehended or tolerated in this country.

What the deluding persuasions of the three chief executives failed to give you was this. What is the reason, what is the seed bed from which springs the so-called network monopoly power? I am going to tell you what it is. It is their total authority, explicit and unchallenged, which allows them to make "yes" or "no" final decisions about what goes on or what does not go on national prime time television.

The three networks in prime time are the only national force in this country. Cable only reaches 54 percent. The independent stations do not have that kind of reach. Only the three networks and their 600-plus affiliates do; and they have total authority to say yes or no. The most powerful media company, Mr. Chairman, Time, Warner, Paramount, Fox, if they all merged, would be helpful and hapless before a fuzzy-checked little network vice president who said "no, buster, get out of here." They are gone. They do not have any power.

The networks say, however, folks, we are in big trouble here, and we have got to have more power. And mind you, Mr. Tisch said to you how he wants a level playing field. What Mr. Tisch did not understand or tell you was FISR is the instrument that provides a level playing field. Without FISR, it is tilted toward the networks.

The networks say they need more revenues and a changing environment, and they need to be freed from restrictions. You know, the networks remind me of what they used to say about the Bourbon dynasty in France, Senator Hollings. They said the Bourbons learn nothing, and they forget nothing.

I would go on to another line, but Senator Breaux just preempted my best line that I have been rehearsing for three days, for God's sakes.

The CHAIRMAN. Go ahead. I will listen to it.

Mr. VALENTI. Mr. Chairman, I am going to present you this chart again. This is one the networks do not like to see. I did not make this chart up. Broadcasting Magazine did. They are no enemy to the networks. They are not trying to hurt them.

What this shows is the stuff you send to the SEC. It is not what they tell you. It is what they tell their security analysts so they can get their stock up. It shows that these networks have made hundreds of millions of dollars, both in their O&Os and in their networks.

Mind you, Broadcasting analysis says these O&Os—and do not divorce them from the networks—are cash cows. Morgan Stanley says that they have pre-tax profit margins, Senator, of 48 percent, and their networks are doing just fine.

I want to separate out this tin cup, crying for more gruel, because it is an absolute artifice, and everybody in the business knows how well they are doing. And how they can tell you differently with a straight face is absolutely beyond me.

The second reason for change is the network says well, we are all restricted, and everybody else can do whatever they choose to. That is just simply not right.

Mr. Chairman, I am going to tell you—I have another little chart; I always bring my charts with me—this is what the networks can do right now, even as we sit, without one change in anything. They can go into movie production, movie theater ownership, movie distribution, network program production, pay per view, pay television, cable program networks, cable program production, direct broadcast satellite, home video, foreign syndication of their own internally produced shows, book publishing, records, magazines, you name it. As a matter of fact, as has been established by questioning, they are in all these areas right now.

In just 16 months the greatest prize of all is going to be laureled on their noble brow; they are going to be able to produce and own 100 percent of all of their 22 hours of prime time. And if you do not think that strikes terror into the hearts of independent programmers, you are wrong. Because when you own and produce a program, when you have the power to say yes or no, no one can challenge it. Senator Gore's question to these gentlemen was very, very appropriate.

And do not ever forget that in addition to the networks and the O&Os, they have vast holdings. For God's sake, GE is a $50 billion corporation. It ranks number three on the Fortune 500. It is one of the Nation's leading defense contractors. More gruel, more gruel. If FISR is ever discarded or if it is ever radically revised, I am telling you, competition dies. It is as simple and as deadly as that. Which is why every independent programmer, large, small, medium sized, every independent television station, every consumer group have all banded together in this coalition to preserve the Financial Interest and Syndication Rule.

Who are the allies of the three networks? Who is clamoring to change this rule? Well, I will tell you. It is the three networks. They ain't got no other. There is nobody else there, because every professional in this business understands with unvarying clarity what the rules of the game are. The networks are in total command, and if you strip away this one leveling portion of the playing field, it is all over.

We are currently engaged in negotiations with the networks, and I hope if there is time here that one of you will ask me a question as to just what is going on in those negotiations. I will be willing to tell you again, with as much clarity and candor as I can, why we cannot reach a deal. We have a specific program on the table that fits exactly what Mr. Murphy and Mr. Wright were talking about being partners; and when they give you this 11 hour/11 hour business, it sounds so sweet and simple. Because under congressional rules, if you are here at 1 and somebody else is 100, you sell at 50, do you not? It does not work that way in our business. I can tell you why this 11/11 is one of the most absurd charades ever born of the mind of man.

Finally, if we are going to deal worthily with great issues, then we have to deal fittingly with important details. I am saying to you, to allow three giant corporations to carve out a larger power and national prime time television would be, in the words or Tallyrand, worse than a crime; it would be a blunder.

I am absolutely fascinated with what I am saying, Mr. Chairman, and I could go on a lot longer, but I will, in the interest of time, conclude; and I hope there are some questions that you might put to us later on.

[The statement and questions and answers follow:]

STATEMENT OF JACK VALENTI, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MOTION PICTURE ASSOCIATION OF AMERICA

Each year, a long time ago, President Lowell of Harverd used to greet the incoming freshman class. He would speak to them about what they could expect to find in the next four years. And then he would conclude with a bit of advice. "Always", he said, "keep your eye on the distant objective and not the one nearest you."

Never was sounder counsel offered. The sinister fate that gets in between public officials and public policy is the neglect of that flawlessly wise admonition.

Let me be specific. In television, this nation has a distinct objective. It is this: Competition above all else in national prime-time television.

At the heart of the issue is a revealed truth: Television is not the same as citrus groves or canned goods or Harley-Davidsons. Or any other American product. Television is more potent, more mystical, because it flies on gossamer wings. What American families see in their homes on a television screen is the single most powerful emotional, social and political force in all the land. We have watched with terrorizing fascination the political earthquake in China. And we have been privy to where and how the battle is being waged: on television. Moreover, when rebels seize a country, or when the sitting government resists insurrection, the first action taken by each side is to control television, for whoever controls television controls the country. One doesn't need a politicial primer or inspired guidance to confirm the gist of that claim, not only in a political upheaval, but also in the daily give-and-take of the commercial marketplace.

What Americans, know, see and hear of news, education, entertainment, and sports is preeminently borne to the home through the television screen. Therefore, unless we knowingly abase the essentials of a free and loving land, our government must, at all costs and in spite of all pressure, never allow a tiny group of corporate entities, no matter how seemingly benign the management, to establish dominion over this most pervasive of all human influences. The network's monopoly troika cannot be permitted to insert itself into control of national prime-time television, else we squeeze the life out of competition and turn over sovereignty of the prime-time airwaves to three corporate chief executives.

Our national 'distant objective' is to encourage competition. So long as competition is alive and thriving on the television screen, the nation protects itself. But the three networks have a 'short-term objective.' They want to increase their profits. Nothing ignoble about that goal, except the public interest doesn't demand a piling on of network revenues as a requisite for a competitive marketplace.

If ever our long-range objective is blurred by the deluding persuasions of the three national TV networks, the nation is the loser. The evidence against network control is overwhelming. To believe otherwise is to be discolored by the networks illusory arguments.

Let us begin at the beginning, when the Federal Communications Commission, captained by a Chairman of clear eye and resolute will, looked at national prime-time television and found it soiled by a tri-monopoly. The FCC burrowed into the nooks and crannines of network programming practices and what they fouund was a lack of diversity manacled to network dominion of the prime-time airwaves. The networks forceably took a percentage of independent TV producers' shows. Producers had no choice. Only by caving in could they get their program on the network prime-time schedule.

The FCC, dismayed by and even fearful of what they uncovered, moved swiftly to redirect its compass course toward the long term objective of "competition in the TV marketplace."

Listen to the FCC Report and Order of May 4, 1970: "The three networks' combined participation in all evening (6–11 figure which, when added to the number of network-produced shows, reveals a rise from 67.2 percent to 96.7 percent." In a summation, the FCC Report and Order said: "The overall result is that, save for about 6 percent or 7 percent of their schedules which were the result of direct dealing between independent producers and sponsors, networks accepted virtually no entertainment program for network exhibition in a 5-year period in which they did not have financial interests in syndication and other subsequent use."

And so, the FCC constructed the Financial Interest and Syndication Rule, or in shorthand fashion, FISR. Simply stated, FISR prohibited the networks from taking a financial interest in any show owned by someone else, and barred the networks for engaging in the syndication business. In the vast multitude of government rules and regulations there has been scattered among this maze a few that truly work. FISR is one of those rare regulations that actually has done what, in the public interest, it was created to do. It should be noted that the FCC was not alone in its discontent with the network tri-monopoly. In 1974, the Department of Justice filed anti-trust suits against the three networks, charging them with anti-competitive behavior. In 1977 NBC entered into a consent decree. In 1980 ABC and CBS followed suit.

The Department said the networks "have restrained trade [and] have combined to monopolize, attempted to monopolize and monopolized prime time entertainment programming shown on each network."

The Justice Department asserted that the networks engaged in a series of practices inimical to competition. "Prior to the FCC's effectuation of [FISR]," the Justice Department said, the networks "conditioned producers' access to [their] combined and affiliated group[s] of television stations upon the producers' relinquishing certain valuable rights and interests."

"It was [the networks'] policy to require independent producers, in conjunction with the grant of a network exhabition license, to give up subsidiary rights and interests in their programs," including distribution rights, merchandising, music and literary rights, and 50 percent of their profits.

It was also the networks' policy to require independent producers to give up "other rights and interests in their programs," including renewal options (at pre-set prices), exclusivity as against other communications markets, spinoff rights, and the like.

The networks suggest that these practices were on the wane in the years just before the FCC adopted FISR. The evidence collected by the Justice Department showed just the opposite.

What was FISR created to do? FISR's objective was to introduce competition to a prime-time TV market where before precious little had existed. It succeeded, achieving precisely what the FCC had designed to to do. FISR gave birth to hundreds of independent programming companies, all hotly competing with each other to the public's benefit. It broke open the barn where independent TV stations had been contained, so that where only 71 independent TV stations existed before the Rule was passed, today there are over 320 in operation. It opened a national TV window onto diversity and change. It spawned a robust first-run syndication market. Before FISR, just three companies bestrode the national prime-time pathway, dictating judgment and ideas. Now, that power, unfit for a democratic society, has been shrunk.

The networks crave a change in the Rule and have publicly clamored for its abolition or radical revision. Therefore, the burden of proof is on them to provide that change is worthy in the public interest. My own judgment is the difference between keeping the Rule and rupturing it is, as Mark Twain once remarked, 'the difference between lightning and the lightning bug.'

To uncage the networks so that they are armed and ready to once again dominate prime-time television is to infect competition with a tri-monopoly virus. The reason? That competition is fragile, at best, and could be shattered if FISR is modified or withdrawn. The public would be the loser. The networks' power lies triumphantly enshrined in their total command of the national prime-time television schedule. Only three men, one at each network, can say "Yes" or "No" to the exhibition of any program on national prime time. The most powerful of all non-network media companies is helpless and hapless before the negative gaze of a fuzzy-cheeked network vice president who says "No."

What gives ABC, CBS and NBC total mastery over prime-time television is their authority, unchallenged and explicit, to make YES or NO final decisions about who gets to be exhibited on national prime time, and who doesn't. It is what armors the three networks in their unique status as Masters of the Gate in national prime-time television, for whoever is turned away at the Gate is exiled from national viewing. The source of that authority springs from an FCC decision over thirty years ago. By assigning both VHF and UHF frequencies in each TV market, the FCC, quite unknowingly, I daresay, guaranteed that only three national networks could ever exist. Why? Because the FCC assigned only three VHF frequencies to most major television markets. Whoever else aspires to be a 'national network' must rely on UHF affiliates, and UHF stations are not as strong nor as well reviewed as the more powerful VHF outlets. "Reach," which is the 'sine qua non' of television marketing, is defined as the number of viewers that can tune into a network program. The "reach" of ABC, NBC and CBS is about 98% of all television homes. At this moment the cable industry cannot "reach" beyond 54.8 percent of US TV homes wired to cable.

This "reach" into practically every American home, unduplicated by any other distribution system, is why the networks have dominating control over national television. Given this immense power, what is the network case for giving them more power?

They say, one, they need more revenues in a changing environment, and two, they are restricted when all others are free to roam the marketplace. The networks remind me of the Bourbon dynasty in France: They learn nothing and they forget nothing. Here, then, are the numbers, the arithmetic of the business. You be the judge: Are the networks in trouble or do their cries of poverty have the resonance of delusion?

The networks complain they desperately need more net revenues. Yet, the towering profits of the networks have produced a huge ballooning in network stock values, a doubling of ABC and CBS stock prices within the last couple of years, and an ever increasing worth of the shares of General Electric, owner of NBC.

In the first quarter of 1989, the networks' profit reports are luminous. Even CBS, the lowest Nielsen-rated network, reported record first quarter earnings, $56.3 million, with the broadcasting group's gain a whopping 194 percent over the comparable period last year. ABC's first quarter net rose 18 percent to $82.8 million.

Broadcasting magazine, a publication of demonstrated accuracy, and no enemy of the networks, reported that in 1988, from network and owned-and-operated TV station operations, NBC piled up a profit of $537 million, ABC a profit of $595 million and CBS a profit of $195 million. Mind you, the three networks don't publicly break out the cost and revenue numbers for their O&O TV stations and the network apparatus. But Broadcasting's analysis tells us the O&Os are cash cows, immensely valuable, [Morgan Stanley estimates profit margins averaged 48 percent last year], and the network distribution system is very healthy.

Every professional in the business knows that CBS, ABC and NBC would sooner have their fingernails pulled out by a Stillson wrench than give up their O&Os. The network is part and parcel of an enormously profitable operation. The network is the engine that feeds its massively prized TV stations, concentrated in the largest markets in the country. The O&Os of the three networks are fixed forever in the thickly populated cities of the country: ABC owns TV stations in New York, Chicago, Los Angeles, San Francisco, Houston, Philadelphia and Fresno. NBC owns TV stations in New York, Washington, D.C., Chicago, Cleveland, Los Angeles, Denver and Miami. CBS owns TV stations in New York, Los Angeles, Chicago, Philadelphia and is purchasing one in Miami.

People who truly understand today's television marketplace see only too clearly the dominating grasp of the three networks which lies just beneath the seemingly innocent entreaties of their relentless lobbyists.

Consider, too, that network profits are rising in spite of huge fees paid by the networks to license sporting events. The networks claim they lose money on sports, which makes their increased overall profits all the more significant. Sports licensing fees have exploded, rising to the heavens in higher and ever higher fees. NBC's Olympic expenditures, a total of $500 million for rights purchase and production costs, would finance their entire year-long prime-time entertainment schedule! CBS bid one billion dollars for baseball rights, almost $1 million per inning, with no "back-end" syndication rights. No food stamp folks, these networks. But sports licensing fees have gone crazy because the networks bid against one another. That is what fierce competition yields. But *networks do not bid against each other for prime-time entertainment series,* which the networks "lock in" through options for at least four years at a fixed price. Which is why entertainment series license fees have remained more or less static while sports licensing fees are in orbit.

But despite these fat sports fees so grandly paid by the networks, their fiscal health was never better, their financial cheeks never rosier.

So we glimpse a scene out of Oliver Twist, the three networks, in baggy clothes, living among the homeless, tin cups in their calloused and scrawny fingers, crying out for "more gruel, more gruel." Frankly, to paraphrase Lord Macaulay, there is no spectacle so ridiculous as the three networks in one of their periodic fits of desolating poverty.

More numbers. In spite of cable, in 1988, 84 percent of all national television advertising was exhibited on the three networks. The three networks took in $9.6 billion, a rise of 8.7 percent over 1987. Cable extracted but 8 percent of this national advertising fund, with the remaining 8 percent going to barter syndication. The three networks' national ad revenues are more than *ten times that of some 40 national cable networks, combined.*

The networks assert in Washington that cable is cleaning their ratings clock. (I might add that is not what they tell security analysts.) The fact is that in first-quarter 1989, in *all* homes in America watching TV, 70 percent are tuned to network programs.[1] In non-cable homes (which is about half of the country), viewers in 83 percent of those homes watch network prime time. According to the latest Nielsens in all US homes, if you added up the ratings of *all* cable programs, basic and pay—(CNN, ESPN, USA, TNT, HBO, Showtime, Cinemax, etc.)—*their total combined viewership would be ¼ the audience of the networks!*[2] In "cable homes only" the audience for network shows in prime-time is double the combined viewership of all cable programs. Or to put it another way, when folks in cable homes are watching either cable programs or prime-time network programs, *two-thirds* of those watching are tuned into network prime-time programs on network-affiliated TV stations brought into cable homes.

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[1] Nielsen "Monthly Cable TV: A Status Report," April, 1989.

[2] Nielsen Homevideo Index "Cable Activity Report, First Quarter 1989."

The most fierce competitor of the networks is the independent TV station, whose growth flows from FISR. Independent TV stations challenge the networks with popular off-network programs. Without FISR, the independent stations would be exiled from the licensing of these popular shows. No network executive, if he had the power as once he did, would give independent TV stations popular off-network programs to compete with network O&Os and affilates for audiences. And if the networks reclaim that power, then say "Hello" to speedily increased network profits, and "Goodbye" to independent station competition!

The second reason for change, cry the networks, is: "We are restricted while others can do whatever they choose."

As of now, on this day, at this hour, the networks are *free* to do all and everything that any small or large program production companies can do, *except* enter the two areas where they have behaved anti-competitively and where both the FCC and the Department of Justice found them colliding with good commercial deportment as well as in conflict with the law: First, the networks cannot extort from a producer an ownership share of his or her program as a price for getting a slot on national prime-time television. Second, the networks cannot be involved in syndication, which would collapse the future of independent TV stations in the land.

Because monopoly is endemic in both cable and network prime-time TV, the three networks are also barred from owning cable systems. Thank God for this. Without this barrier, the networks, with their huge resources, would either combine with cable to create one giant leviathan or assert their fiscal authority to such a dimension that, literally, there would be a vast and darkening assumption of power by a very few over what each family sees or doesn't see in the home, a monopoly over television never before comprehended or tolerated in this land.

Right now, the networks can: enter movie production and movie distribution; operate movie theaters; produce and own cable network programming; own and control pay-per-view facilities; enter the pay-cable arena; produce and market home video material; lease, produce and distribute satellite-to-home programs; and syndicate abroad all their network-produced programs. They are already deeply involved in many of those arenas.

Do not forget that each of the three networks at this moment has giant holdings in other important areas, *in addition* to their immensely valuable owned and operated television stations:

Capital Cities/ABC, with $4.8 billion in revenues last year, publishes nine daily newspapers, 52 weekly newspapers and shopping guides, 82 magazines in business and consumer news, trade and agricultural publications, data base services and inspirational communications. Moreover, CapCities/ABC owns 80 percent of ESPN and has an interest in Arts & Entertainment and Lifetime, two cable networks.

General Electric, owners of NBC, with just under $50 *billion* in revenues, ranks third in assets on the Fortune 500 list of the nation's biggest corporations. GE is a leader in over fourteen key businesses including financial services (GE Capital Corporation, which is a billion-dollar-plus lender to cable companies; Employers Reinsurance Corporation; Kidder, Peabody Group), plastics, medical systems, aircraft engines, lighting, industrial and power systems, appliances, aerospace, communications facilities and services, motors, transportation systems, factory automation, as well as an expanding international apparatus. GE is one of the nation's largest defense contractors. It also owns cable network CNBC and a share of the Rainbow network.

Loews Corporation, which registered $10.5 billion in sales last year, is the controlling stockholder in CBS. Loews owns Bulova Watch Company, CNA Financial Group, CNA Insurance Company, Loews Hotels, Lorillard, Inc. (one of the preeminent manufacturers and marketers of cigarettes), and joint ventures in CBS/FOX Home Video.

In addition to all these vast related and unrelated business enterprises owned and controlled by these giant corporations, there is still one more prize awaiting them. In just sixteen months, an element of a Justice Department anti-trust consent decree expires. Each of the three networks will be able *to produce and own 100 percent of all its prime-time programming.* Hear me closely. I said *100 percent.* That means every minute of each network's twenty-two hour weekly prime-time schedule. By producing their own programs, the networks leap beyond FISR, encircling the marketplace with the Rule still in place. That's why the networks do not want to achieve any concord in negotiations with producers. Why should they? They will either succeed in demolishing FISR officially, or devastating it unofficially. Why make a deal, when you can't lose? That's why the lifting of this Justice Department consent decree has a terrorizing sound to it.

Do I sound like an anxious paranoid? Not if you understand the definition of a paranoid, which is a fellow who is in possession of all the facts. Examine the recently announced network schedule for the fall.

The three networks *almost tripled* their share of the network-produced-and-owned *prime-time series market* for the 1989/90 season. For the 1988/89 season on NBC, CBS, and ABC produced 0 percent, 3 percent and 2 percent respectively, of all series ordered, including mid-season, for a total of 5 percent. For the 1989/90 season, NBC, CBS and ABC will produce 5 percent, 5 percent and 3 percent of all series ordered, for a total of 13 percent.

The crushing significance of this statistic falls most heavily on smaller, independent producers. The sharp increase in network-owned production for the 1989/90 season came almost entirely at the expense of smaller, non-studio production companies whose market share fell dramatically. Is it the policy of the three networks to gradually put the squeeze on independent producers? If this trend continues, every show available to the public during network prime-time will bear the creative stamp of just three network executives and the sound you will hear is Diversity choking. The independent producers of today, especially the smaller companies, will be network employees tomorrow, reflecting the ideas and views of the network tri-monopoly.

If FISR is ever discarded, or radically revised, then competition dies. It is as simple and deadly as that. Which is why practically every independent production company, every independent TV station, consumer groups and national advertisers are all banded together in a Coalition to Preserve FISR. Whereas the allies of the three networks are: the three networks.

More than revenues is at stake. The very business life of the independent programming and TV station community is put to hazard. But more at risk is a public policy which has baffled, so far, the very few from commanding every television entry into the American home.

That is why so many Americans in and out of the program production and independent television station community plead with the current and soon to be seated FCC Commissioners, plead with members of the Congress, and with the Administration, to keep their eyes on the distant objective and not a short term objective so zealously sought by a very few.

Lack of Competition is always bad for the consumer, but the presence of Competition is always good for the consumer. That is a marketplace truth which cannot be extinguished, and a consumer benefit which cannot be replaced. It is a Truth that the Congress at the peril of the public interest neglects or allows to languish.

If we are to deal worthily with great issues we must first deal fittingly with important details. To allow three giant corporations to carve out larger power in national TV prime-time entertainment would be, to paraphrase Talleyrand, worse than a crime, it would be a blunder.

When a Rule is working, as it was intended to work, when the marketplace is thriving, when competition is alive and robust, is the public interest advancing by bowing to the will of three huge networks, backed by corporations of intimidating power, whose sole aim is to increase the glow of their quarterly income reports?

Let us, then, keep our eye on the distant objective of this nation: The preservation of Competition in the television arena. That, my dear friends in the Congress, is the single most important political issue in any democratic society, especially our own.

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS THERETO [1/]

Q: Do you expect the network's share of prime-time audience to continue to drop? Why?

Answer: Although network prime-time shares may _drop modestly_ over the next several years, coming off huge shares in previous years, the analysts all agree that the total number of people viewing network programs will _increase_. Generally, analysts estimate that network viewing shares in all U.S. homes will settle out at about 65%, from a current level of about 68%.

Network revenues, however, _will rise at a compound growth_ of 6% or higher.

There is plenty of agreement on this subject.

An article in the June 14 issue of _Weekly Variety_ (Tab B) cites a report by the investment banking firm Veronis, Suhler & Associates, respected industry analysts, predicting that: "_Some further erosion_ [of network share] is expected over the next five years, but at a _slower rate_ than over the previous five." The same study, says _Variety_, "predicts the big three networks will bask in a 6.9% annual compound revenue growth from 1989-93. Moreover, those news items about network-share losses will finally cease in 1993, when network share levels will hold at 63%."

All analysts agree that the networks are unique. They are the only three enterprises capable of delivering a _national_ audience. This is the key to their power. Veronis, Suhler concludes:

> "Despite suffering decreases in viewing share, the networks remain the _only medium_ that can efficiently deliver a large national viewing audience. Although smaller than in the past, the networks' audience remains large enough, in an era of splintering in media alternatives, to keep _the networks unique and economically attractive to mass-market advertisers_...

[1/] The Tabs referred to were not reproducible.

> Over the next five years, although the networks' share of television viewing will continue to decline, the absolute number of people watching network television should increase modestly. Networks will then become a stabilized rather than a declining medium. As a result, network advertising should grow at a higher rate than over the previous five years." (emphasis supplied)

Paul I. Bortz, of Bortz & Co., Inc., a frequent adviser to the networks, in a speech to the ABC affiliates in Los Angeles last June (Tab C), predicted that cable viewing share will rise from 8% today to 15% in five years, while network share of prime-time audience will drop to 65%. Cable, viewing however, will be split among 20 services or more, while the network share will be divided among just three entities. "What is the mass advertising video delivery medium in the 1990s?" he asks. "It's the networks and their affiliates."

The central fact of network power is contained in their *rising profit margins* and actual profits earned, and their ability to raise advertising rates, because of their *unique position in the distribution of national prime-time programming*.

A headline in the July 3 issue of *Broadcasting* magazine (Tab D) trumpets, "Networks Riding A Bull Market... *1990 Three-Network Earnings Could Be Twice Those Of 1988*. (emphasis supplied.) All three networks raised advertising prices, often by more than 10% from a comparable period a year earlier.

The article says that because the networks assumed "little or no decline in viewership and sold more advertising units in prime time, the overall dollar figures [for cost per thousand viewers] grew even more dramatically."

The article notes stock analyst Jay Nelson of Brown Brothers Harriman is expecting CBS to earn roughly $100 million in 1989, double his earlier estimate of $50 million. Other analysts (see attached article) also raised their estimates.

The article concludes, "If the profit estimates do prove correct, 1990's profit for ABC, CBS and NBC could *exceed $600 million, or roughly double* the amount the three took in last year--excluding acquisition accounting adjustments."

These figures belie the *false phantom of free TV demise* invoked by the networks. In view of their boosted profits and sales, given the rosy forecasts by expert observers, based on the absolute fact that only the three networks can command a national audience, the networks' death chant for free TV is a sham, and it ought to be so branded. Those who monitor the networks for the press and for investment bankers count the networks to be fiscally robust, market strong, without national competitors, and therefore to have unrivaled power in the field.

Take sports. Paul Bortz admitted in his speech to the ABC affiliates that ABC transferred the Sunday/Thursday NFL games from its broadcast network to its cable network, ESPN, because the NFL games did not make enough money for the network in prime time.

Again, listen to the networks' own consultants. Bortz advised the networks and their affiliates: "There is one factor I can assure you isn't a root cause of the revenue problems of the television broadcasters. It is the factor that is most often cited as the primary cause of softness in the television marketplace--the development of new distribution channels via cable... The current softness in the television advertising market is *not due* to declining ratings and shares." (emphasis added)

Bortz instead blamed the networks' strategy of creating a new 15-second spot ad category, which increased supply at a time of soft demand. He terms the decision to sell the 15-second spots for half the price of 30-second spots "a major mistake" that further depressed advertising prices.

David Poltrack, Senior Vice President of Planning and Research for CBS, in a presentation in New York last December, outlined the results of a study by the CBS Marketing Division on cable's share of viewers (Tab E). Poltrack points out that *cable TV audience growth has slowed as cable penetration growth has slowed* and that audience growth has been greater for the smaller local and regional services than for national, measured cable networks.

He concludes: "With homes passed [by cable] approaching the expected limit and remarketing efforts to-date [sic] failing to convert a significant number of original cable rejectors, future audience growth based on increased penetration will not approach the growth rate of the past decade." (Tab E, P. 17) This slowdown in cable growth should help to halt the slide in network audience shares.

Finally, MPAA would like to submit to the Subcommittee a study it has commissioned by the independent firm ICF Consulting Associates on the economic condition of the networks (Tab F). Its in-depth analysis shows:

* There are *no substitutes* for network advertising. The networks continue to have a unique asset in their ability to reach nearly every U.S. household with an advertising message. Because of this their financial base remains firm.

* Much of the networks' recent profit performance is explained by general U.S. economic performance and by other factors peculiar to recent years rather than by a loss in audience share. Indeed, judging by the performance of network stocks, the *stock market has great confidence in the networks' financial performance.* Compared to a broad range of stocks,

the networks performed above expectations and investors have been well rewarded for the risks they have taken, ICF found. The networks' economic arguments, therefore, do not support repeal of FISR.

Q: Motion picture studios now own both cable systems and television stations, and one studio has started the fourth network. When you combine these facts with exclusive distribution contracts, why should Congress not be concerned about what appears to be a significant increase in the market power of the studios?

Answer: The major producers today *do not have market power*, as the data for the following answer demonstrate clearly. The kinds of activities the committee refers to are *very limited* in scope. Only one MPAA member company owns cable systems. The other seven do not. One company, Fox, owns seven TV stations and has an ad hoc two-evening-a-week network comprised mostly of small UHF stations. Disney owns one TV station, as does MCA--both independent stations. In no case are these stations market leaders. No other company owns TV stations, although Paramount has purchased an option to acquire an interest in a company which will indirectly own seven UHF stations, two of which are contemplated to be sold.

Producers *compete fiercely with one another* to offer the best programming to the widest possible audience through the greatest number of avenues. They vie with each other for writers, directors, actors, editors, composers--in short, all the talent required to produce quality programming.

The major production companies not only with each other but *with network producers and independent producers*, any filmmaker with a camera, a vision and the talent to carry that vision through. There is no limitation on who can make a movie or produce programming. *No matter how large its size, a major studio cannot produce quality on demand.* Like any other producer, the studio takes its risks in the marketplace of public opinion. This is true in selling programming to the networks and cable TV, in theaters, videocassettes, syndication and foreign markets.

There is no artificial barrier to entering the production market. On the contrary, production is characterized by ease of entry. Program production is the entertainment industry's "software," and like computer software, any novice programmer with basic skills who can produce and sell product can enter the business. There is no technical barrier. No one needs a permit or government license. With the open market created in part by the Financial Interest and Syndication Rule and the consent decree limitations on network production, independent producers in particular have grown and prospered.

Program producers have *many options* to finance and produce programming. The same is true for distribution and syndication. Major studios often perform distribution or syndication services, for a fee, for smaller producers who wish to take advantage of their national distribution capacity. But independent producers can, and do, distribute and syndicate their own product if they wish, or turn to myriad syndicators competing with the major studios.

As for exclusive distribution contracts, exclusivity is a restraint on the rights of the *seller* of the program, not the buyer. An exclusive contract, which the networks and some cable networks demand, limits the seller's ability to shop programming around. The fact that TV programming is usually sold on an exclusive basis is a reflection on the *market power of the buyer*, not the seller.

Finally, as demonstrated below, when the benchmark tests of market competition are applied to the businesses at issue in the FISR debate--prime-time TV program production and TV program syndication--it becomes *numerically clear* that those markets are not concentrated, that the system in fact is in balance.

Q: Isn't it true that the major studios are bankers for the independent studios, meaning that they are the primary sources of capital for the smaller producers?

Answer: The term "independent studios" refers, we assume, to independent producers of television programming, or those producers that, in general, do not have a physical plant or distribution capability. Independent television producers find financing through a wide variety of financial arrangements. As production costs and deficits continue to increase, external sources of funding become that much more important to the independents, although some independents, such as Stephen Cannell and Aaron Spelling, self-finance production deficits. Wall Street has been another source of capital to certain independents. The studios are a third source of funding. We believe that association with a major studio provides an independent with a well-financed, well-directed partnership with a player that has a long-term stake in the television business, is not tied to one network and has every incentive to maximize the value of the program in every possible market. Successful series such as GOLDEN GIRLS are examples of the results achieved through partnerships between independent producers and major studios.

Senator **Inouye**. Thank you very much, Mr. Valenti. You have not disappointed us.

May I call upon Mr. Cannell?

STATEMENT OF STEVE CANNELL, STEVE CANNELL PRODUCTIONS

Mr. **Cannell**. Thank you, Mr. Chairman. I feel like I should do a dance or something to get this going.

My name is Stephen J. Cannell, and I am the Chief Executive Officer of Cannell Productions, and we are the producer of prime time television programming. And I am here to plead for the future of independent production companies and the thousands of people that work in the independent production field, because without the Financial Interest Rule, I certainly would not be in business today. Unless it is retained, I think we are all certainly going to be forced out of business in the future. So plead I must here.

First, let me tell you how I got here. I have been in the TV production business for 18 years. I started at Universal where I worked for eight years as a contract writer, eventually becoming a writer, producer and creator of such shows as "The Rockford Files," "Baretta," "Baa Baa Black Sheep," among others. And because of an entrepreneurial streak inherited from my father, I decided in 1979 to leave Universal and do something quite extraordinary. I decided I would try to set up my own studio, one man with a dream. I would write, and produce, and own my own programs.

And I was advised by the studio executives not to do it, but I was encouraged by ABC. You see, they wanted more independent producers, so they would not have to deal with the very powerful studios. They wanted diversification. They said it enhanced their creative options, and because they could not own the programs themselves. They actually encouraged my defection from Universal, and I went into business. ABC guaranteed me three pilots, and Stephen J. Cannell productions was born.

Since 1980 we have produced more than three-quarters of a billion dollars worth of programs and 17 different series, including "The A-Team," "Riptide," "Hunter," "Greatest American Hero," "Hardcastle and McCormick," "Tenspeed and Brownshoe," "Wiseguy," "21 Jump Street," among others. And with five hours of programming on the air for this coming fall, Cannell Productions has become the second largest programmer of prime time television in the industry.

It was a difficult trip with many sleepless nights trying to solve my cash flow problems and my network relationship problems, twice almost going bankrupt. But I made it through only to find out that there is a possibility that the very rule which 10 years ago made it possible for me to attempt this venture may be repealed, allowing networks to take a piece of my off-network syndication rights, instantly making my company an indentured servant to them. And if the Financial Interest and Syndication Rule is overturned, I think my choice is to either close up my company and go to work for the networks or stop working.

And if you doubt this, take a look at the current TV season. And we heard from the network executives here how they have not been buying their own product willy-nilly, but I do not see it that way. Of the four hours bought by NBC for the fall, four hour shows that they bought, two were from their own in-house production company; and additionally, there were segments of the Disney Hour which are now also being produced by NBC, which I find questionable. One can only suppose that this was part of a deal Disney had to accept in order to get that low-rated series renewed. Additionally, to make certain that they would not run short of their in-house product, NBC also bought a third series from itself as a backup for mid-season.

CBS bought two in-house productions for fall, and ABC announced that it was forming a new entity with its former entertainment president to produce many prime time series. Yet, these networks assure us that they will not abuse the system and buy 100 percent, if 100 percent is allowed.

As a writer, I will stay away from the fox and the in-house metaphor, but let us just realize that their intention certainly is to dominate all of the programming themselves, own it, distribute it, control it. That is their plan, and they are gearing up to accomplish it. And if they succeed, everything that you see on television will be controlled by the minds of three people.

And I ask: Is this healthy? Is this good for the American viewing public? Is it good for the production community and the thousands who work there? Would you want to work in an industry where three people control buying, selling and profits? If the answer is no, you must retain this rule and protect us from three network domination.

Now, you might ask the question and say that network television is controlled by the three heads of programming anyway, so what is the difference. Well, to examine that, let us go back to the 1970s. Norman Lear has an idea that will revolutionize half-hour television. He pitches the idea to ABC. They do not get it. They turn it down. In a world where there is no Financial Interest and Syndication Rule, Norman would more than likely be under contract to ABC.

You heard Mr. Murphy say that they would go out into the marketplace, and they would try desperately to get the best creative people, and that means put them under contract. So he would be a contract employee of ABC, and that would have been it for "All in the Family." It would still be sitting in a dead file at the network. But because he was an independent, he could go across the street to CBS and sell it to them. And as a result, a new form of television was born, the socially relevant comedy.

In 1984 Marcy Carsey and Tom Werner pitched "The Bill Cosby Show" to ABC, and they said no. NBC bought it, and the TV world was enriched. My own series, "The Rockford Files," was initially written for ABC and sold to NBC. "Wiseguy" was pitched to NBC and sold to CBS. This happens constantly. "Taxi" left ABC to go to NBC. "Father Dowling" left NBC to go to ABC. All of this would end.

In a way, the writer-producer in today's market is a honeybee pollinating ideas at all three networks. What a tragedy to have only one place to sell, to be unable to keep trying until one of the three networks finally decides to take a chance.

Often, networks order pilots from writer-producers just to keep them from going across the street. So, you see, the fact that we do not work for them keeps many ideas from dying; and often it is the most innovative types of programming that need this sort of leverage to get on.

I could talk briefly about the economics of television. In 1981 when I made "The Greatest American Hero," which ran for three years, production costs were approximately $800,000 to $900,000 per hour. Our first year license fee was $711,000, and we got approximately $50,000 in foreign fees, so our deficit per hour—and that means what we had to pay ourselves, my company, my small, independent company—was around $100,000 an hour of television. If we did well and we got 88 episodes, which is what we need to get into the syndication marketplace, we would sell the show for $400,000 or $500,000 per episode, and we would make a nice profit. However, if the show went off the schedule—and that was something we had absolutely no control over—before that all important 88th episode, we would be left with whatever our production losses were. And there was almost no market for a series with less than 88 episodes.

It is not a great business, but if you keep your success ratio up there, you can make some money. Today, first year license fees are up only slightly over 20 percent in the nine years. However, in those years the cost increases in several years of double-digit inflation, the cost of producing a show in L.A. has gone up from $800,000 to $900,000 to around $1.3 million. That is a 50 percent increase over the same nine-year period. And the producer of hour-long TV series is in serious straits as a result of this.

Network profits have skyrocketed, while production companies have to struggle to stay in business. The networks have posted huge profits, all documented in their annual reports, and yet they have not improved license fees to keep pace with production costs. We are being squeezed out, and now they want to get a piece of what is left—our dwindling syndication profits.

I hope you understand how desperately the Hollywood production community views this situation. I am not here alone. I am really here for a lot of other people. We are forced to live in an oligopoly with three dominant corporations, but at least we can go from one to the other in our search for a home for our programming. It is not perfect, but it creates some balance, and it works.

I stand before you today an example of a worker who has an entrepreneurial spirit and who was allowed to accomplish a dream by virtue of this rule. I plead with you, do not repeal the Financial Interest and Syndication Rule. Without it, I fear my company will perish.

Senator INOUYE. Thank you very much.

[The following information was subsequently received for the record:]

THE CANNELL STUDIOS

MICHAEL J. DUBELKO
PRESIDENT

August 18, 1989

Senator Daniel K. Inouye
Senate Commerce Communications Subcommittee
Room 227 Senate Hart Office Building
Washington, D.C. 20510-6125

Dear Senator:

Enclosed please find the answers you were looking for.

Q: The networks claim that if the financial interest and syndication rules are repealed, they will help fund small, independent producers that cannot otherwise get funding. Do you think this would be the result?

A: The answer is that the opposite will happen. Small independent producers will be forced to allow the networks to own the rights to their ideas in exchange for getting programs on the air. Currently, small independent producers are able to compete in the market place since they are able to finance production via distribution deals with many of the major studios. Because of this favorable economic climate, smaller companies have been started and have prospered such as the Carsey-Werner Company, Lenn Hill Productions, etc. Furthermore, if the networks are so interested in helping small producers, as they have claimed, why don't they raise license fees to cover production costs or provide non-equity based financing to help the smaller, economically disadvantaged producers.

Q: Would it be fair to say that for a significant number of independent producers, particularly the smaller, less well known, that it is virtually impossible to produce a television show or series without the financial support of a studio?

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A: The answer is with regards to productions that are either high-budget oriented or deficit-prone, smaller, less well known independents have used the major studios as a financing source through the sale of domestic syndication and foreign distribution rights. Since the smaller, less well known independents generally have little or no ability to handle their own distribution, this process both addresses their need to raise capital for the production as well as provide distribution services when the product becomes available for sale.

Q: How many television station shows or series have you produced without any involvement by one of the major studios?

A: From 1980 through 1986, all series produced by this company had some involvement with a major studio, mostly involving foreign distribution. This amounted to approximately 10 series. Since then, we have produced 6 series that have had no involvement or dependence on any major studios. Because or our lack of capital when this company was started, if there were no FISR, we might have had to give a large portion of the ownership of our programs to the networks, if they had demanded it, in order to get our programs on the air.

Q: Please provide the Subcommittee with the following financial information concerning your company.

A: The next seven questions deal with financial data. While Stephen Cannell offered to share this data with the Committee, upon advice of counsel, I must regretfully decline to provide that information. We are a private company and do not publish this information. My advisors tell me we cannot do so now due to the highly competitive nature of our business and the possible adverse impact on our company of releasing this information.

However, Stephen Cannell expects to be in Washington this spring and would welcome the opportunity to sit down with the Committee staff to discuss--off the record but in great detail-- how the business economics actually works.

Best regards,

Michael J. Dubelko

Senator **Inouye**. Mr. Kellner.

STATEMENT OF JAMES KELLNER, PRESIDENT, FOX BROADCASTING CO.

Mr. **Kellner**. Mr. Chairman, thank you for inviting me.

Before I get into the text of my testimony, there are a few comments that I would like to make.

First off, I am very concerned about the financial interests and syndication rules because they have leveled the playing field out a bit for us. We are a new venture. We are a tiny little company, 125 local independent stations spread all over the country.

And there were a few comments that were made earlier that I would like to address.

One of them was—there was a question about whether the quality of programs could be maintained at the three networks, if they were not given a part of the profits from the shows. I can assure you that there are other competitors ready, willing and able to step into their restricted shoes and take on the challenge of providing high-quality programs if any of the networks would like to get out of the business and release their VHF affiliate line-ups.

The other point that I would like to emphasize is that owned-and-operated stations are really the cash cows, the point was made earlier. Fox Broadcasting would never have gone into business if we had not owned seven television stations. It is the responsibility of this little network to feed programming to the stations. And really, the stations are the ones that make most of the money. And if you look at that analysis of the profits of the three networks, you must include the owned-and-operated station profits to get a clear picture of what is actually going on there.

I would also like you to understand about our business. We started out 26 months ago trying to build an alternative service to the three networks. Interestingly enough, there were only a very few VHF stations left. Our coverage is made up predominantly of UHF stations; 87 percent actually.

In this regard, you can be assured when NBC Entertainment President Brandon Tartikoff referred to Fox as "the coat hanger network," he was not paying a compliment to us. It was a humorous reference at that time to our weak local stations and viewers standing behind their TV's with coat hangers, bending them into shapes, trying to get some form of snowy reception.

The joke, he hoped, at that point, would deter stations, advertisers and producers from believing we could even become a fourth network. He, of course, as do most of the people in the network game, prefer a club of three individuals only.

But there is certainly some truth to what Mr. Tartikoff said, and Mr. Wright knows it as well. They also have UHF stations and they know that in 13 markets where they have a U, and ABC and CBS have VS, that their programs do not perform as well. In fact, even though NBC is first in prime time, first in late night, first in early morning, close in daytime and close in news, in every case the NBC affiliate in those 13 markets, the UHF NBC affiliate, was last in weekly Qume. And that is from the last May sweep report.

And it is also absurd to let the financial interests and syndication and prime time access rules that were designed to curb the abuses of the three networks come crashing down on our little venture, Fox Broadcasting Company, before it reaches any semblance of their economic power or their competitive position. Those rules were never intended to apply to potential competitors like Fox or its station partners.

We began providing service in April 1987. Currently we have 5.5 hours of programming on each week. Almost half of our schedule, by the way, is made up of news and informational programs. On Saturday we have a 60-minute magazine show called The Reporters; we also have a show that deals in science and technology called Beyond Tomorrow. And about a month ago we moved a show in called Cops, which is a reality-based show that follows police officers on their beat. Two weeks ago, we went to Leningrad and to Moscow to watch how the Soviet police actually handle their responsibility.

On Sundays we have a show called America's Most Wanted, which the FBI has credited with being directly responsible for capturing 50 of the Nation's most dangerous fugitives. And, Mr. Chairman, Richard Yoshino, who is Hawaii's most infamous fugitive, on the run, I think, for 15 or 16 years, he was captured four days after he was profiled on our show.

We are also responsive in our entertainment shows, responding to the reference made before about concern for teenagers, we have a program that Mr. Cannell produces, it is called 21 Jump Street. It has a very, very strong service element. After most of the shows we provide a public service announcement to help kids find answers to their problems. It resulted in a Presidential Citation awarded to Mr. Cannell's company and Fox Broadcasting. We are the only network to receive one, if we are called a network.

We are very proud of all of the programs we put on the air. We look at them as alternatives. That is why this venture of Fox and its local partners represents such an important and possibly unique turning point in this country's decades old quest for national broadcast competition. We and our partner stations undertake this challenge against extreme, and what sometimes seems insurmountable odds.

We are fighting 40 years of network domination of our industry. We have to overcome the FCC's Spectrum Allocation Plan, which was designed to accommodate and to benefit three and only three networks, leaving Fox and any other new entry to compete principally with UHF television stations.

I hope I made my point on UHF weakness earlier; it is certainly not new thinking. The FCC's multiple ownership rules recognize it as a matter of law, counting a UHF station at one-half the value of a VHF station for purposes of national coverage.

This competitive disadvantage describes Fox's plight today. Fox has 16 VHF affiliates. Our VHF affiliates have a potential reach of only 24 percent of the country. If you take ABC, CBS and NBC, it is 85 percent, 85 percent and 91 percent for NBC. This disparity is startlingly clear in the comparison between CBS and FOX on the coverage map easel right there.

If you look at the pink, that is Fox's VHF coverage. The blue is Fox on U's. If you look at the other chart, the CBS VHF line up is in pink. The U is blue. NBC and ABC have similar advantages.

I hope I can convince you how unlikely, how impossible it is for Fox's UHF program service to structurally or fundamentally be equivalent to the networks now or at 15 hours. Only someone with an over-active imagination, I believe, who is blind to the facts of the broadcast market place, could think otherwise.

For a realistic comparison, please look at the UHF television signal 60 miles from a transmitter. The FCC Table of Allocations, the national advertising revenue splits, the big three's domination of the Nielson charts, or, for that matter, any objective comparison of power and potential in this industry. The disparity in every case is overwhelming.

Rumors to an end to network domination of this market place, I think are greatly over-exaggerated. I have just gone into this business 3.5 years ago trying to start a national program service. And after listening to these gentlemen, I should be depressed to think about the business I have gone into, except I know better. I know what a good business it is despite the appeals for more profits from our competitors.

So let us look ahead at schedules: ABC, CBS, NBC, 93, 103 and 99 hours of regularly scheduled programming, each of them. And that is not counting Olympics, Superbowls or any others special programs; Fox, 5.5 hours of programming. About 6 percent of their clearance. Revenues: Fox has 1.6 percent of the pie in 1988. That leaves 98.4 percent of the national network pie for the three networks; CBS has 18 times Fox's revenue and they're the lowest revenue-based network.

Our audience, Fox's total reach, 89 percent; the networks each have 99 percent. And it is doubtful, because there are no more stations for us to affiliate with, that we can get beyond 89 or 90 percent in the near future.

And if you want to look at ratings, the Nielson ratings is what we all use in this business to see how well you are doing, seven of our shows rank in the bottom 11. Fox's highest rated program was 59th out of 89 shows. Our average Fox program ranked 80th out of the 89 shows. Fox's highest share ever, by the way, was an 18 share. It happened in February, about four months ago. We threw a party for our entire 130-person staff. And I can assure you, the networks, which have had shares even this past year, as high as 70, they would not have a party for an 18 share.

Today our stations are more likely represented by WETO in Greeneville, Tennessee, than like the strong affiliates of ABC, NBC and CBS. This station is up for public auction right now. It is a Fox partner station. If it was not for Fox, by the way, I doubt anyone would consider buying it. The only hope for the station is that Fox can succeed and grow and provide a program source for the station.

The time clearly has come for a rereading, reevaluation and reexamination of FISR's definition of network to ensure that the FISR rules can continue to apply consistent with their underlying purpose. We propose such a new definition in FCC filings and in our written testimony today. That definition contemplates that if we do ever reach parity with the networks using any fair, reasonable criteria, we would expect to be regulated like the networks are regulated.

We hope that day will come for us. I think it is a long shot. It may come. There are some glimmers of success and some glimmers of hope. It just comes a lot harder for Fox and it comes less frequently for Fox.

The issues we face are simple: will the American viewers be permitted to receive the benefits of effective competition to ABC, CBS and NBC? I believe they should. I believe the answer should be a resounding yes. I have made it my career, but sadly it may be no. Because the networks may succeed in their attempt to twist the meaning of FISR restrictions intended to promote diversity and new competition in order to stop us, our little Fox Broadcasting Company and other enterprises that may follow behind us.

The result would leave the networks again free of competition, to continue to dominate national broadcasting, program production and advertising time sales. And that would be perverse.

I hope you do not let that happen.

Thank you.

[The statement and questions and answers follow:]

STATEMENT OF JAMIE KELLNER, PRESIDENT AND CHIEF OPERATING OFFICER, FOX BROADCASTING CO.

Good morning, Mr. Chairman and Senators. As President and Chief Operating Officer of Fox Broadcasting Company, I'm happy to be here this morning to talk about Fox's efforts to bring competition to the national broadcasting marketplace. I'm also here on behalf of 125 local independent stations which are our partners in the Fox Broadcasting Company venture.

I'd like to talk about two things this morning. First, I'd like to tell you about our company: our accomplishments in the brief 26 months we've been on the air; and the enormous problems we face as an alternative program service due to both the engineering and economic drawbacks of our line-up -- 87% comprised of weaker, less mature UHF stations--and a marketplace dominated for 40 years by the three networks.

In this regard, you can be assured that NBC Entertainment President Brandon Tartikoff's reference to Fox being "the coat hanger network" was not a compliment. He was making a joke he hoped would deter advertisers and producers from believing in a potential network competitor. He, of course, prefers the club of three. But, there is some truth in the joke, and Mr. Tartikoff knows well the weaknesses of UHF stations. You see, NBC has UHF affiliates in 13 markets where ABC and CBS have VHF affiliates. In every case, NBC's runaway first place national ratings position is lost in the local market due to its UHF affiliate's weakness, with each of those NBC UHF affiliates ranked third.

Second, I hope to convince you of the absurdity of permitting Federal Communications Commission ("FCC") rules designed to control the abuses of ABC, NBC, and CBS to come crashing down on our young company. Fox is, after all, the new entrant the rules were intended to foster. Those rules, the financial interest and syndication rules ("FISR") and prime time access rules ("PTAR"), certainly were never intended to apply to an entity like Fox or its station partners. If that were to happen, Fox and its partners will be caught in a regulatory Catch-22; that is, first encouraged to provide a programming alternative and then stopped at the first glimmering of competition to the Big Three. The result would be harmful to Fox, our station partners, and the public interest.

The issue we face is simple: Will American viewers ever be permitted to receive the benefits of effective competition to ABC, CBS, and NBC? The answer should be a resounding "yes". But, sadly, it may be "no".

Why? Because the networks want to twist the meaning of regulatory restrictions intended to promote diversity and new national broadcasting entrants in order to quash competition once and for all. They want to jettison the fundamental public interest in media diversity that is at the core of our federal communications policy. The result would leave the networks free of competition to continue to dominate national broadcasting, program production, and advertising time sales.

Please, don't let them do it.

Fox Broadcasting Company began providing primetime programming to our lineup of 125 independent station partners in April 1987. Last year, we offered 10 1/2 hours. Due to competition in the market, we dropped a one hour, late weeknights show. We now provide 5 1/2 hours of programming, and we've announced that we will add another 1/2 hour on Sunday nights and 2 hours on Monday nights by September.

At present, almost half of the Fox schedule is made up of news and informational programming. The entire Saturday night schedule is filled with pro-social shows: The Reporters, a hard-hitting, one hour news magazine program; Beyond Tomorrow, a half hour magazine that examines new and future technology and inventions; and COPS, which follows real police officers on duty. Last month COPS broke new ground in journalism when it followed local Russian police on duty in Leningrad and Moscow.

On Sunday night Fox offers, among other shows, America's Most Wanted, hosted by John Walsh. This program presents information in an effort to apprehend dangerous fugitives. This is more than a television show. It's a nationwide neighborhood watch. We operate a hotline for information which might lead to their arrest. The FBI and other law enforcement agencies have credited the program with the direct responsibility for capturing 50 of this country's most dangerous fugitives, including, Mr. Chairman, Richard Yoshino--Hawaii's most infamous fugitive: on the run for 15 years, now captured in California four days after he was profiled on the show.

Even some of our entertainment shows, like the issue-oriented 21 Jump Street, produced by Mr. Cannell, have an added element of public service. That police drama has proven especially attractive to young viewers and gives special attention to those problems facing the young people who make up so much of the program's audience. Generally, the show is followed by a public service announcement where one of the show's popular cast members gives more information--or a hotline phone number--for viewers to deal with the problems--say, drugs, runaways or abuse--covered in that week's episode. Mr. Cannell and Fox were singled out this year for a Presidential Citation for 21 Jump Street.

We're very proud of these programs. They are innovative and wouldn't be available to the American viewers but for our alternative service.

We've spent many millions of dollars to develop our program schedule. And as in any programming venture, we've taken expensive risks and suffered expensive failures. But we've also had some happy successes. In a mass medium, Fox and our station partners offer more opportunity for creativity, for experimentation, for innovation--for failures, yes, but also for new achievements.

That's what it's all about. And that's why this venture of Fox and its local partners represents such an important--and possibly unique--turning point in this country's decades-old quest for national broadcasting competition. Respectfully, Senators, I believe what my colleagues and I at Fox are doing is exactly what the FCC and Congress were asking for. We've demonstrated our willingness to devote substantial resources--capital, energy, and commitment--in an effort to provide to viewers an alternative national program choice, to advertisers another path to consumers, and to program producers another buyer. All these opportunities are a departure from a world firmly controlled by the three network chieftains.

I reaffirm our commitment again today.

We've made no profits, but we've impressed some of the audience and if this trend continues, some day we can be profitable.

In the long run, if we are allowed to grow, we believe one day we will be an effective competitor. But I can assure you, barring a miracle, that time is far off in the future. And it certainly has nothing to do with Fox's place in today's market and the challenges we now face.

We and our partner stations undertake this challenge of offering a new voice against extreme and what sometimes seem like impossible odds. It's not just the normal risks of producing television shows. It's the weight of 40 years of network domination of broadcast television.

Jack Valenti, President of the Motion Picture Association of America, has accurately and vividly described the genesis and, unfortunately for us, the continuing vitality of the networks' domination. But there's another structural reason for it which is of fundamental importance. That domination will continue to be the inevitable consequence of the FCC's decision to mix VHF and UHF stations in the same market. That spectrum allocation plan, adopted in the late 1940's and early 1950's, was designed to accommodate and to benefit three, and only three, networks.

The result of that decision is a patchwork of leftover UHF stations. Most of these stations, in fact, were established less than 10 years ago. And thanks to Fox, only in the last 26 months they've started to show that there may some day be strength in numbers.[1] FISR were an effort 19 years ago to try to begin to undo the harm caused by the FCC's original allocation decisions and they've been a big help. But even they can't change the disparity between VHF and UHF stations--or between those stations available to the networks and those available to new entrants such as Fox (which is dramatically depicted in national ADI maps comparing Fox's station line-up with that of ABC, CBS, and NBC.)

The problem isn't the rule per se; it's the FCC's definition of "network". Section 658(k) of the Commission's rules defines "network" as "any person, entity or corporation which offers an interconnected program service on a regular basis for 15 or more hours per week to at least 25 affiliated television licensees in 10 or more States...." That was fine as a definition when it was a cute, subtle way to say "ABC, CBS, and NBC."

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[1] In this regard, Fox may be fulfilling the goal of FISR to encourage the development of new UHF stations and strengthen their role in the local marketplace. By associating the weaker local stations with a developing national service, that goal becomes more approachable. This, of course, helps fulfill the basic goal of diversity which is the centerpiece of communications policy and, consequently, of these hearings.

But now Fox and other competitors have begun to emerge. In the other instances where application of the definition threatened to force the FCC to take action inconsistent with the purposes of the rules, the Commission, recognizing and citing the aim of the rules, simply waived them. In doing so, it acknowledged that the rules were not intended for new entrants, that the specific hour number was adopted without explanation and without support, and that other factors, such as the characteristics of a particular program service or its affiliated stations, might better distinguish between those entities the rules were intended to restrict and those outside their scope.

In Fox's case, the same rule of reason should apply. A decision that these rules don't apply to Fox is a must. Any other interpretation would be contrary to the purposes of the rules.

Indeed, it is absurd to intimate that under any fair test Fox or any other entity is structurally or functionally equivalent to the networks, especially at only 15 hours of programming. Any such suggestion can only be the result of an overactive imagination of someone who is blind to the facts of the broadcast marketplace. For a realistic comparison, look at a UHF signal, the FCC's table of allocations, the national advertising revenue splits, the Big Three's domination of the Neilsen charts, or any other of the straightforward indicia of power and potential in broadcasting. The disparity is overwhelming.

First, and most immutably, is the UHF disadvantage. No alternative program distributor can effectively compete with the networks for that very simple and unchangeable reason. The allocation table provided for only three networks capable of clearing any significant portion of the country with VHF affiliates. Everyone else ends up with a line-up almost entirely made up of UHF stations.

No matter how you engineer them, UHF stations simply can't produce the picture quality or signal reach of VHF stations. UHF stations must broadcast at higher power levels--and higher costs (50 times higher for the power alone). Even then, UHF signals are more attenuated by terrain and structural obstacles.

In fact, due to the significant propagation differences, UHF stations have never achieved parity with VHF stations. "VHF channels are likely always to remain somewhat superior to UHF for television broadcasting due to fundamental laws of physics over which we have no control...."[2] Thus, anyone who wants to compete with ABC, NBC, or CBS must do so with stations described by the Wall Street Journal in a recent article on Fox as "in snowy UHF country."

They're right. We undeniably face an uphill battle against the laws of physics. That was the view of the Network Inquiry Study almost 10 years ago. The Study, a staff report to the Commission, came to this conclusion: if a new national broadcasting entrant affiliated with a UHF station in a market in which the networks already have VHF affiliates, the new entrant suffered a distinct competitive disadvantage.[3] Fox stations always will have the technical reach problems the FCC and this Congress long have recognized as a disability.[4]

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[2] See, e.g., Report and Order in General Docket No. 78-391, Improvements to UHF Television Reception, 90 F.C.C.2d 1124 (1982).

The FCC has reaffirmed this view of the UHF disadvantage recently--and in the context of concerns about national power and influence similar to those at issue here. The power that can be exercised by the VHF-dominated networks, for example, was one of the issues raised at the time the FCC adopted changes in the multiple ownership rules to allow group owners to own 12 rather than 7 television stations. Key Senators and Congressmen persuaded the FCC to reconsider its purely numerical decision and to add a provision limiting to 25% the national coverage "reach" any one group could have. The purpose, as with FISR, was to make sure no entity could increase its clout in the program acquisition and other national broadcast markets.

However, the resulting rule took special account of UHF's plight. Despite the concerns about national reach, UHF stations were counted at only a 50% value because of the "inherent physical limitations" of UHF.[5] The discount reflected a "continuing concern with [the UHF] medium" in light of its "fundamental limitation... physically to reach viewers...."[6]

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[3] Network Inquiry Special Staff, New Television Networks: Entry, Jurisdiction, Ownership and Regulation, vol. 1 at 78 (1980).

[4] Id at 1121.

[5] Memorandum Opinion and Order in General Docket No. 83-1009, Multiple Ownership of AM, FM and Television Broadcast Stations, 100 F.C.C.2d 74, 93 (1985).

It's hard to understand how the FCC could make such findings four years ago and now treat Fox--and it's largely UHF program service--as if it had the full force and effect of its VHF network competitors. Clearly, some kind of discount is appropriate here, too. At the least, it should engender a recognition that the decades-old definition of a network can't be read without reference to such factors as impaired coverage and reach.

By the way, reality bears this out. As Preston Padden, President of the Association of Independent Television Stations, testified yesterday, the average UHF independent television station--that includes 109 of the 125 Fox affiliates--lost over $1 million in 1987. 1988 figures are not expected to be much better.

This competitive disadvantage describes Fox's plight today. Fox has 16 VHF affiliates. See Attachment 1. 87% of our affiliates are UHF. Our VHF affiliates have a potential reach of only 24% of the country. The networks reach 85%, 85%, and 91% of the country respectively, with VHF affiliates.[7] See Attachment 2.

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[6] Id.

[7] We've prepared national DMA charts which highlight VHF affiliates in pink and UHF in blue. White areas are uncovered by any station. If you look at the comparison, it is startlingly clear how severely disadvantaged Fox really is.

The allocation scheme simply never envisioned any national programmer other than the three existing networks. It was this, among other reasons, that led the Network Inquiry Staff to conclude that there would be no new competitors to the networks. As they pointed out, the 1952 table of allocations "seriously handicaps...additional networks by limiting their coverage and forcing them to affiliate with UHF stations in markets with many viewers."[8] And they concluded that the practical effect was "to limit television to a system dominated by three over-the-air advertiser supported networks."[9]

Even apart from the UHF disadvantage, which itself is enough to treat Fox and any other competitors differently than the networks, Fox is not now--and at 15 hours will not be--equivalent to the networks. Despite attempts by the networks and their affiliates to paint a grim picture of the crumbling and decay of ABC, CBS, and NBC, an accurate view of today's broadcasting environment should look to Mark Twain not, as they would, Robert Malthus. Rumors of the demise of network domination of the national marketplace have been "greatly exaggerated."

-- Take schedule: ABC, CBS and NBC have 93, 103, and 99 hours of regularly scheduled programs, respectively. Fox with 5 1/2 hours, presently has less than 6% of the average network schedule. Even at 15 hours, Fox will only air 15% of the network average!

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[8] Network Inquiry Special Staff, New Television Networks: Entry, Jurisdiction, Ownership and Regulation, vol. 1 at 139 (1980).

[9] Id.

-- Take revenues: A comparison of ad revenues for 1988 shows Fox with 1.6% of the total. See Attachment 3. The networks split the remaining 98.4%: ABC, 31.7%; CBS, 29.5%; and NBC, 37.2%. CBS, the network with the lowest revenues, still generated over 18 times Fox's revenue. The network average is over 20 times Fox's revenue.

-- Take audience: Fox's total reach (crediting UHF at 100%) is 89% as compared to 99% for the networks. It's doubtful Fox will ever reach that coverage level.

-- Take experience: Fox has been on the air less than 3 years as compared to 36 years, 41 years, and 43 years for the networks.

-- Take ratings: Fox's highest share ever for a single program was an 18. ABC, CBS, and NBC had 71, 77, and 69 respectively. And that disparity is evident in day to day ratings as well. The Neilsen National Index season average rankings of national shows through June 4, 1989, for example, ranks Fox shows in the bottom 5 places, and with 7 of the 9 Fox shows in the bottom 11. Fox's highest rated program ranks 59th out of 89 shows. On average, Fox's programs ranked 80th out of 89 shows.

Fox, as was well publicized, lost almost $100 million last year alone and we expect an over $150 million capital loss investment overall. There's no question that these are still the formative years for competition.

Despite this pessimistic--though realistic--profile, and despite the fact that the laws of physics have not and, without some miracle of engineering, will not change, Fox has taken on the network challenge. We believe in our stations. We believe they will grow and mature.

But today, our stations are more likely represented by WETO, Greeneville, Tennessee, than the type of strong station affiliated with the networks. The bankruptcy auction announcement for WETO, a Fox partner station, appears on the cover of this testimony. You'll notice, as we unfortunately do, the Fox logo right smack in the middle of the public auction flyer.

Mr. Chairman, I am on this panel with others who support the continued preservation of the FISR. Let me say, categorically: we support retention of FISR. We believe the world has not changed substantially since those rules were adopted. The rules were formulated to foster the development of competitive "new broadcast television networks and other alternative program sources."[10]

Those restrictions were not created for the purpose of hurting ABC, CBS, and NBC, enriching program producers or ensuring full employment for Washington government relations firms. Their purpose was to encourage new entry into a marketplace absolutely dominated by three well-entrenched networks--to open the gateway to the American television viewers.[11]

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[10] Memorandum Opinion and Order in Docket No. 12782, Competition and Responsibility in Network Television Broadcasting, 25 F.C.C.2d 318, 333 (1970).

[11] Now, another bottleneck has developed--this time in exhibition rather than distribution--with the monopoly position cable system operators enjoy. This is being made all the worse by concentration in that industry and massive, unchecked vertical integration.

Consequently, I'm hard pressed to understand why the FCC or Congress would want to view FISR, or more precisely, its definition of "network", as applicable to Fox when such a reading would subvert the very purposes of the rules. That ruling would cause Fox to have to choose between the trauma of an enormous forced divestiture or the equally untenable position of having to indefinitely tread water at 14 1/2 hours--an amount of programming which couldn't sustain a competitive national program service in the long run. We would be forced to focus all our efforts on one daypart--primetime where profit margins are slimmest. Is it appropriate to only encourage diversity and competition in primetime and leave network domination in place in daytime, late night, news, and sports?

It's not as if the definition of "network" were finely crafted to assess the point at which a competitor becomes a co-conspirator, guilty of having the power to make its competitive role a destructive, rather than positive, force in the broadcasting marketplace.

In fact, the definitional benchmarks fail miserably to accomplish the job for which they were intended, i.e., serving to identify those national broadcasters with the ability to dominate the marketplace. For example, say a service provided 15 hours of programming to stations in the smallest 25 markets. Under a strict reading of the definition, it would nevertheless be considered a network for purposes of FISR and PTAR--yet it would have a national coverage of less than 1%! Clearly, this definition is flawed.

We know the basis for the numerical benchmarks is undisclosed and unclear. We know that no empirical or legal justifications were articulated. None were needed. After all, we know that the rules were intended for the three networks--no others were contemplated then or foreseen even years later. We know the purpose of the rules was to check network power in the program market. We know that the FCC's desire to reduce the dominance of the networks was directly linked to its desire to induce new entrants to develop into effective competitors. In fact, the FCC emphasized at the time its intent that the rules "clearly...not impede the development of any proposed additional networks."[12]

It would be an absurd, bizarre and sad irony to let the networks preserve the dominance the rules were enacted to foreclose by trumpeting an erroneous reading of the definition in those rules so as to stifle the competition the government was so intent on fostering.

The time clearly has come for a re-reading, re-evaluation, and re-examination to ensure that the FISR rules can continue to be applied consistent with their underlying purposes.[13] That's what we asked the FCC to do last year and what we bid you to do today.

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[12] Notice 12782 at 2158.

[13] Current rulings on this subject have reflected exactly that reassessment. See, e.g., Christian Broadcasting Network, Inc., 87 F.C.C.2d 1076, 1077-78 (1983) ("CBN") (bases for the definition's benchmarks were not discussed in the order adopting the rules "and are unclear as a result"; definition "may frustrate the very purpose for which our syndication, financial interest and primetime access

As you may recall, last summer we asked the FCC to replace the current FCC definition of "network" for purposes of the Financial Interest and Syndication and Prime Time Access rules in Section 658(j) and (k) with the following definition:

> For the purposes of this paragraph [658(j)] and paragraph (k) of this section the term network means ABC, CBS, and NBC and any other equivalent national network.

"Equivalent national network" would be defined as:

> an entity equal to ABC, CBS and NBC as measured by criteria such as coverage, VHF coverage, amount of programming, potential audience, actual audience, advertising revenues, affiliate characteristics, and such other criteria as the Commission in its discretion shall deem appropriate, and shall be determined by the Commission on a case-by-case basis.

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[13] cont'd.
rules were adopted"); Tentative Decision and Request for Further Comments in BC Docket No. 82-345, 94 F.C.C.2d 1019, 1098 n.111 (1983) ("Tentative Decision") (actual language of the definition "was more inclusive" than Commission originally intended); Further Notice of Proposed Rulemaking in BC Docket No. 78-309, FCC 88-127 (released May 12, 1988) ("Network Representation Rulemaking") (network definition accompanying the rules "was adopted by the Commission with discussion, and thus, the bases of the definition's parameters are unclear"; moreover, it may no longer "be desirable to define standards...in terms of the number of affiliates or the number of states served"). See, also, Home Shopping Network, _____ F.C.C.2d _____ (1989). Indeed, in the Network Representation Rulemaking, the FCC proposed "using some measure of the size of the network such as average total audience or average evening viewing audience or annual advertising revenues" and other criteria.

We believe that this definition would provide a better measure of the point at which new competitors need to be restricted to serve the public interest in diversity, and will remove the possibility that the rules will thwart the very goals they were intended to achieve.

At the time, Mr. Chairman, you expressed a concern that Fox's request could hamper discussions between the networks and the television production community aimed at resolving the conflict over the FISR restrictions. As supporters of those negotiations, we agreed, indicating our desire that our request not distract the parties from those discussions. Nevertheless we believed, and still believe, those negotiations would, and will, not deal with the definitional issues raised by Fox's request.

These talks have been ongoing since 1983. Frankly, they have been used as a lobbying crutch on which the networks have frequently leaned. Indeed, the networks seem to have taken those talks seriously only when they could be used to forestall some action by the Congress or the FCC.

We can't be held hostage forever.

The urgency of Fox's request is reflected in the competitive realities it confronts in the national television marketplace. Programming changes frequently and rapidly; opportunities are quickly lost. To plan program development and acquisition, devise advertising sales and marketing strategies, and anticipate technical and engineering requirements, Fox needs to remove the barrier to its future development posed by the unnecessarily restrictive nature of the network definition.

Fox's station partners are equally dependent on a timely ruling. In the main, independent stations contract for programming several years in advance of the date it actually appears on the air. These commitments reflect millions of dollars of advance expenditures. Fox stations need to know whether they will be able to rely on Fox for more--or any--programming in the future; or whether, through a knee-jerk, misguided application of the current rule, Fox will be destroyed by the very rule that encouraged its formation.

Indeed, just last week, our station partners announced a plan to commission and air children's programs. They are tired of offering second rate, sometimes irresponsible programs that weren't made because they were great entertainment or pro-social, but because a fast buck could be made or a new toy sold. On a strip basis, this could constitute 7 additional hours by September 1990.

Those of us who were at Fox three years ago when it all began have vivid memories of being ridiculed by advertisers, stations, producers and the press. They all thought it far fetched to believe anyone could survive in an attempt to compete with the quintessentially entrenched networks. They really weren't far off as a matter of fact. There are murmurs of competition in the national broadcasting marketplace, and I'm happy to say we represent such a murmur. But the murmurs must be listened for closely--their volume is very low. It's been rough, frustrating, and expensive. But, fortunately, we found charter stations, charter producers like Mr. Cannell, and charter sponsors like Bristol-Myers.

I'm not sure we look any less foolhardy in hindsight. The broadcast environment cannot and will not in the foreseeable future change to make Fox's fight to enter the network dominated marketplace any easier.[14] That also means there is, and will be, no abatement which would justify unleashing the anti-competitive reach and power of the networks.[15]

Fox wants to continue to bring new choices and competition. As communications policy makers, you too, have expressed your desire to see more choice for the American people. Viewers are beginning to turn to Fox and others for alternative programs. But neither Fox nor any other emerging national program service can grow to a significant level as long as the FISR is used to cripple new entrants before they have had time to mature. We can't; and nobody else will even try.

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[14] Certainly cable doesn't have a moderating influence on the network dominance. Quite the opposite. It represents another layer of domination without any benefit to the free, over-the-air broadcast marketplace. That, after all, is the marketplace we must examine because it is the only marketplace available to all the American people without charge.

Whatever competition subscription services such as cable provide to cabled homes, they are not universally available and are not free; nearly half of the homes in America don't have cable. So cable or other non-broadcast technologies can't be considered as within the marketplace FISR was intended to fix.

[15] I certainly know about the potential abuses inherent in that power: I was at CBS before FISR were enacted. I knew what we wanted, and what we got, from program producers; and I know the power and intimidation that is levied today, despite the incidental restraints of the FISR restrictions.

We should take a lesson from the way competitors like MCI and Sprint were brought along into the long distance telephone markets long dominated by AT&T. Inducements like equal access were put into place to allow those entrants to compete. Because of the UHF disadvantage we will never have the functional equivalent of equal access. All the more reason, then, for a substantial period of growth, inducement and incentives to be afforded Fox and other potential national television competitors. And all the more reason why FISR should not apply to Fox.

Indeed, the wrong ruling in this case would actually interfere with effective competition. The federal pro-competitive policies are not self-effectuating. To succeed, they require the private enterprise of entities such as Fox risking their capital, expending enormous resources and competing for programs, advertisers, and audience.

Please believe me, this is a great enough task on its own; we can't fight the government, too.

Even as they seek to have Fox treated as a network equivalent for FISR purposes, the networks seek and get special advantages and special treatment based on the differences between themselves and all other broadcasters. Last year, for example, the networks pressed for--and received--special treatment in the Satellite Home Viewer Act. Based on a finding that the networks and their programming was special--occupying a position of unique importance and value to the American people--the networks now by law are protected against satellite competition where they have affiliates. Fox and others are not.

Fair enough. But why do they say in the same breath that there's no material difference between us? And why now do they seek to portray Fox as part of their select club when at every turn Fox is being turned away at the door?

When Fox in 1987 bid for the rights to Monday Night Football against ABC, why was CBS alleged to have used its influence to prevent Fox from winning the bid? Because its no fun having someone break up the networks' intimate "tea for three" that has been the norm in national broadcasting for four decades. And it's no fun--for CBS and NBC at least--to permit a third entertainment choice on Monday nights.

Last year, Fox approached network affiliates in the 11% of the country that Fox doesn't reach, offering to let them carry Fox's two most successful programs not previously broadcast in the area instead of repeat network shows. The Fox programs carried with them more advertising time for the local stations than they'd get from their network. Why were there no takers? I'll tell you why--network pressure. And why was there so much animosity when Fox outbid the networks for the Emmy Awards and disrupted the network's game of rotating that show among themselves?

Because network broadcasting is a cozy three-member club with no room, at least in the networks' exclusionary view, for more. But I'd like to hear them explain why the public's not hurt by such self-serving actions. Somewhere, the goal of diversity got lost.

Fox Broadcasting Company and other like ventures have the potential to make a significant contribution to economic and viewpoint diversity, fulfill Commission goals for the UHF television industry, expand viewer choice, encourage independent production, bring needed competition to the national advertising market, and generally provide benefits in all the areas contemplated by the rules.

That's why we've come to your hearing today. To ask you not to forget our new and toddling company as the FISR football gets tossed back and forth between competing private interests. We too have our own private interests, of course. But in this instance I believe sincerely that our interest happens to coincide with the public's interest as specifically embodied in the financial interest, syndication, and primetime access rules.

We do not ask for subsidy. We do not ask for guarantees. I, personally, believe in the kind of government intervention that ensures fair and effective competition but no more than that; and that's all my company seeks. But, you cannot correct 40 years of marketplace domination by setting free the networks on infant competitors. Woody Allen said it well: "The lion may lay down with the lamb,...but the lamb won't get much sleep."

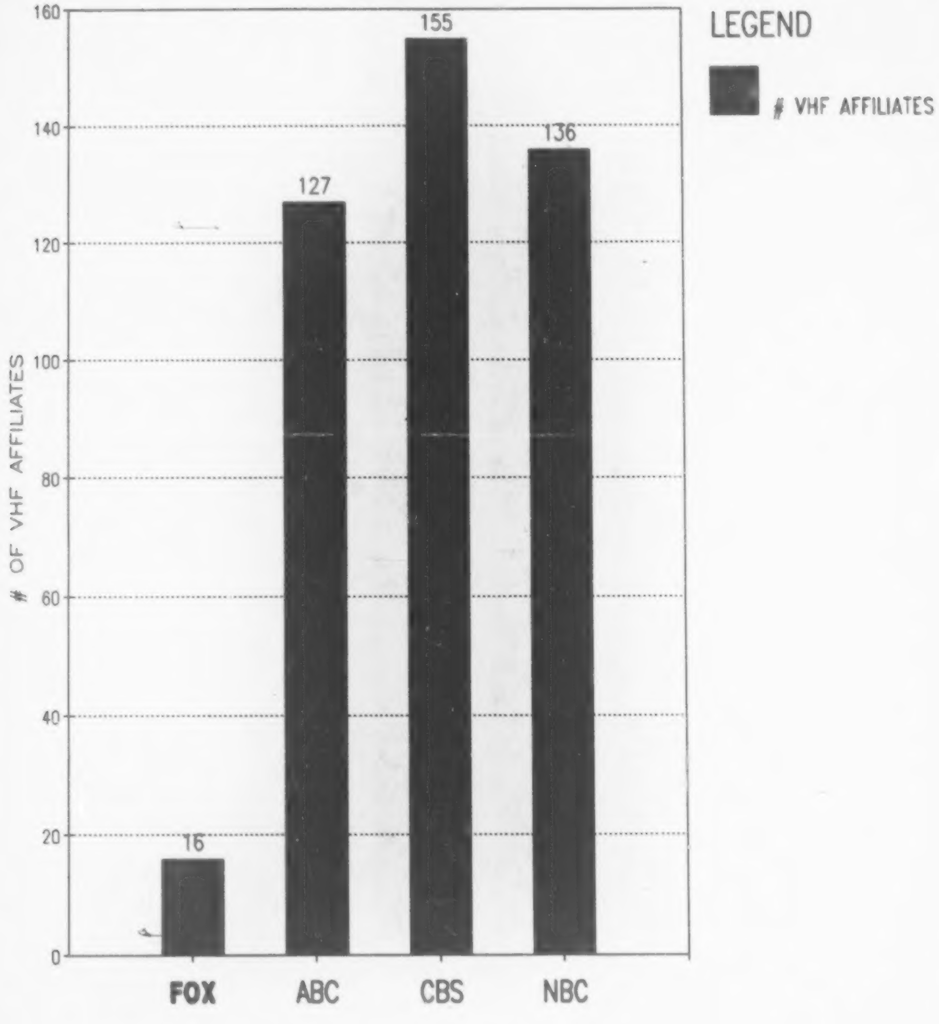
Thank you.

ATTACHMENT 1

# of VHF AFFILIATES

FOX vs. ABC, CBS, and NBC

1989

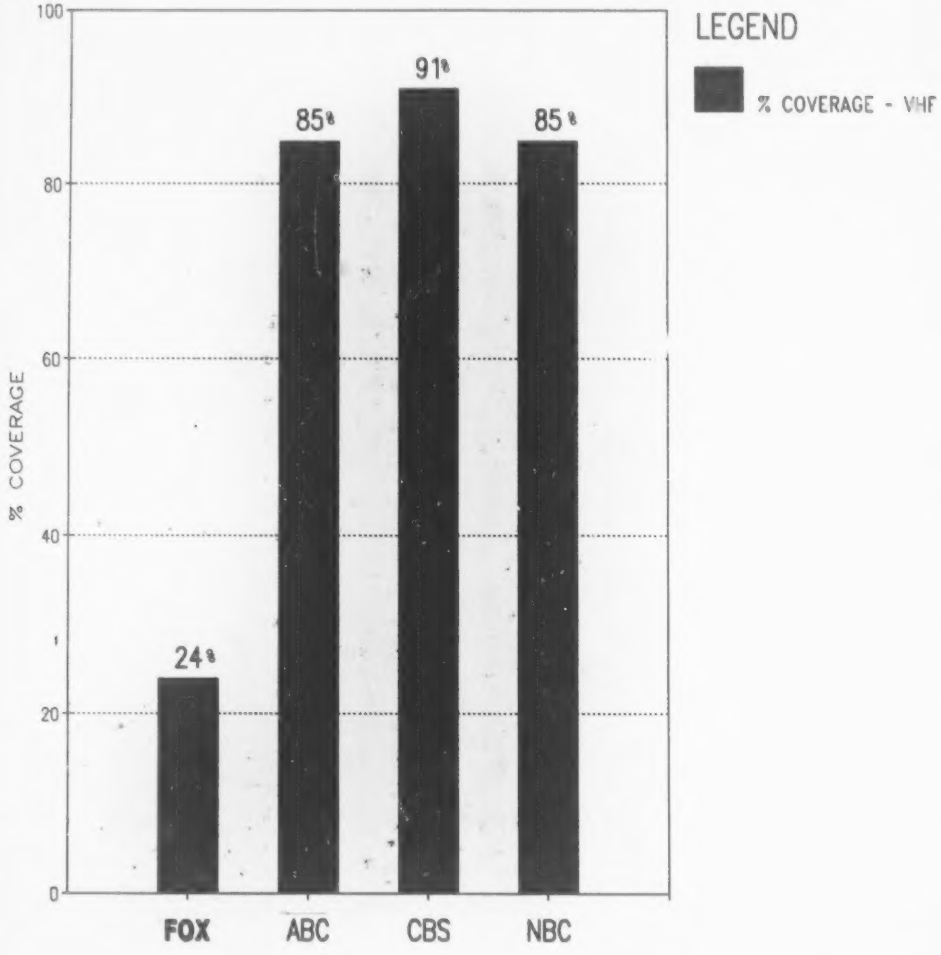


ATTACHMENT 2

% U.S. TV HOUSEHOLD COVERAGE FROM VHF AFFILIATES

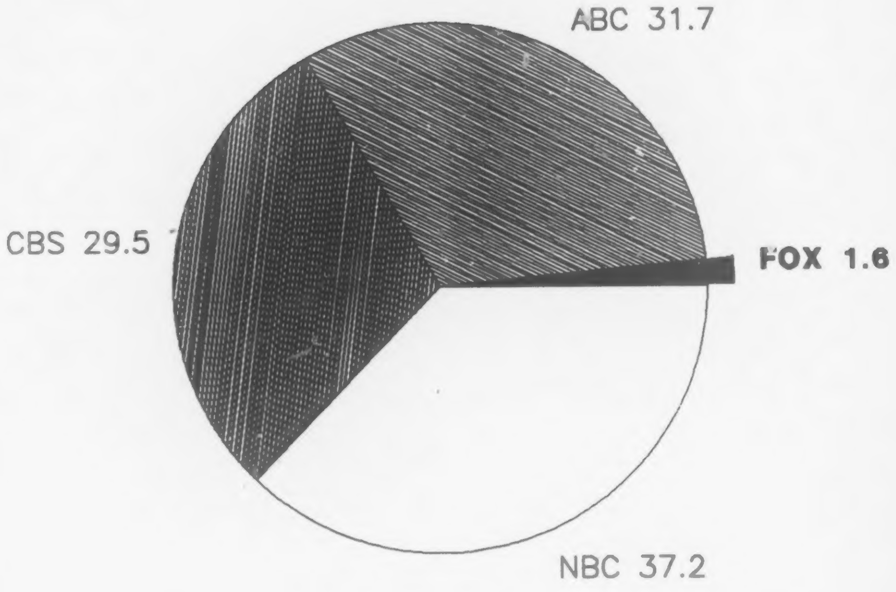
FOX vs. ABC, CBS, and NBC

1989



ATTACHMENT 3

AD REVENUE COMPARISON
FOX vs. ABC, CBS, and NBC
1988



RESPONSES OF JAMIE KELLNER
PRESIDENT, FOX BROADCASTING COMPANY
TO POST-HEARING QUESTIONS
FROM CHAIRMAN INOUYE

Q1. *If Fox is given a waiver of the financial interest and syndication rules, what assurances can Fox give that it won't engage in practices like those that caused the FCC to impose the financial interest and syndication rules?*

A1. The financial interest and syndication rules ("FISR") were established to deal with abuses by ABC, CBS and NBC resulting from decades of domination of national broadcasting. By restricting the most abusive network practices, the rules were intended to encourage competitors to the Big Three in order to provide advertisers, program producers and viewers with alternatives.

Fox does not have the market power that the three major networks had or now have. Fox does not have the bargaining power that the three major networks had or now have. And Fox certainly does not have the historical record of abuse that the three major networks have. Therefore, we are neither in the position to -- nor are we inclined to -- act in ways that should require that these rules be applied to us.

The three major TV networks had that ability and incentive in the Fifties and Sixties, and FISR was adopted to rein in demonstrated abuses. The three major TV networks *retain* the ability and incentive to act anticompetitively. They still dominate the viewing marketplace. They dominate in national reach. Thanks to the FCC's Table of Allocations, they forever dominate in VHF carriage over any and all potential competitors. *These* are the reasons that FISR appropriately applies to ABC, CBS and NBC. Fox possesses *none* of these anticompetitive advantages, and therefore these would would not appropriately apply to Fox.

In any event, Fox does not now seek a "waiver" of the rules. As discussed below, Fox believes the better course is to more clearly and thoughtfully define the nature of the entities to which FISR should apply. The "15 hours" test is archaic and simply not a fair measure of whether the program service holds any kind of market power. The factors we outline below are a better test of such power, and a better litmus for applying the rule.

If the day should ever come when a new network entrant such as Fox ceases to be a pro-competitive force, joins (or threatens to join) the Big Three in oligopolistic behavior, and detracts from (rather than advancing) the public interest, then FISR should apply equally to the new entrant. But if FISR is applied before the new entrant can even bring competitive pressure on the Big Three, this would virtually ensure that the Big Three would remain forever immune from competition.

Q2. If any of the three major networks were to establish a cooperative for various types of programs, along the lines of the cooperative Fox is proposing, should that programming cooperative be treated differently than Fox's?

A2. Fox has not sought to exclude the anticipated two and one-half hours of afternoon quality children's programming from the hours of Fox programming which would be counted toward the 15-hour benchmark. There has been significant confusion on this point, and the origin of the misperception is unclear.

Q3. Instead of granting Fox a waiver of the various network rules, why shouldn't we relax the financial interest and syndication rules?

A3. Modification of FISR is inappropriate at this time because the purposes for which the rules originally were adopted -- restraint of the anti-competitive practices of ABC, CBS and NBC in order to foster competition in national broadcasting -- remain necessary goals which have not yet been achieved. Until the rules have fostered effective national competition which can serve to restrain network abuses, it would violate and impede the public interest goal of diversity to vitiate FISR.

Fox has consistently held the position that these rules are necessary and appropriate for dealing with the dominance of the Big Three networks in the prime-time programming marketplace. We continue to believe the rules are necessary.

Before FISR should be lifted, it would be necessary to show not only that they have worked to stimulate competition and that the networks' dominion has been broken... it would also be necessary to show that lifting the rules would not permit the networks to return to their abusive ways.

There have been some favorable changes in the television marketplace caused by FISR, and those changes have brought with them a modicum of competition. But the rules and the changes they have stimulated have certainly not broken the oligopoly the Big Three have maintained for nearly 40 years. Fox's request for reevaluation of FISR's "network" definition simply is meant to recognize that no competitor can effectively compete in the national broadcasting marketplace with only 14 1/2 hours of programming.

As my prepared statement and the maps attached thereto demonstrate, the Big Three continue to have a tremendous structural advantage over any and all competitors. No other competitor can possibly achieve VHF coverage comparable to that of the Big Three. A fourth competitor cannot possibly achieve VHF coverage of more than a third of the country; a fifth or sixth competitor would have to settle for substantially less than that.

Government policies have consistently recognized the huge disadvantage suffered by UHF stations. For instance, the FCC's multiple ownership rules count the reach of a UHF station as only one-half that of a VHF station for purposes of applying the ownership cap based on a "national reach" of 25 percent.

In view of these inherent advantages of the Big Three networks, and in view of the great distance to be travelled before the Big Three face meaningful competition, this is certainly not the time to relax the rules. Any measure that eliminates or vitiates these rules would clearly quash competition, just at the time that the prospect of real competition is remotely in sight.

That leaves two logical alternatives.

As a general matter, waivers of Commission rules are appropriate in those situations where enforcement of the letter of a rule would be inconsistent with the purposes of the rule. The circumstances of the "network" definition as it applies to FISR is just such a case.

As pointed out in my testimony, neither the FCC nor anyone else ever had any expectation that there would ever be another entity besides ABC, CBS and NBC to which the rule would apply. Thus, the arbitrary definition of "network" seemed to have no practical impact. However, with the emergence of Fox, this arbitrary definition has unexpectedly snared the first entity poised to break the prime-time club of three. If Fox must permanently operate at below 15 hours of programming in order to avoid the impact of the network rules, the networks' monopoly will remain impervious.

While a waiver would be justified, we have decided to take a longer-term view by challenging the continuing validity of the definition of "network" itself. We think there should be a proceeding at the Commission to allow full and wide-ranging debate on the question of whether the current definition forwards the public interest goals of the rule and takes cognizance of the actual circumstances of the television industry. We anticipate that the Commission can give this limited but important request timely consideration. If Fox and its affiliates are to plan for the future, there is a need to resolve this issue soon.

While the effect on Fox's private interest could be essentially the same under either relaxation of FISR or reevaluation of the FISR "network" definition, the effect on the public interest is gravely different. Without the rules in full force, the goal of diversity so important 20 years ago -- and still so important today -- will not be reached. Now and forever, the Big Three will control national broadcasting, national television advertising, and program production. We will never see more than the glimmer of competition, because the networks -- with the Government's help -- will continue to bar the door.

Senator **Inouye**. I have just been advised that there is a roll call at this moment. So, may I call a short recess?

[Recess.]

Senator **Inouye**. I am sorry for this delay. We had two votes instead of just one.

Mr. Valenti, as you suggested, I am asking you the question: What is happening with the negotiations or discussions and what can we anticipate from these discussions?

Mr. **Valenti**. I will be very candid, Senator. It has been my judgment that the networks are in no mood to make any kind of a deal until they have appraised the political landscape, namely the Federal Communications Commission.

I do not believe they were willing to make any kind of concord until their political advisors had been able to see who was going to be on the FCC, the new inhabitants, and whether or not they would be pro-network—that is, willing to take up this issue of FISR again.

I think once the networks come to realize, and I hope that they come to realize this, and I pray it is so, that the FCC is not going to reopen this, then I believe they will make a deal. I think they know politically the Congress does not want to take on this chore.

I am now speaking for myself. The networks have no case. They just want more power and they want more revenues. I do not think that is sufficient to propel public policy toward reopening this in the Congress. Nor do I think it is any incentive for the FCC.

So once they realize that the only chance they are going to have for any kind of revision of this rule is an agreement between independent programmers, independent stations and themselves, then I think they will deal.

We have put on the table, Senator, exactly what Mr. Murphy and Mr. Wright and Mr. Tisch wanted. They wanted to have partnerships and they wanted to go into partnership with the producers. We have put on the table a limited number of joint ventures in which they would be 50/50 partners, with a limited number of joint ventures, and freezing in-house production at five hours, which is where it is right now—or will be before this year is out—and then we would let them be partners in joint ventures.

For example, Steve Cannell would bring them a deal and they would say well, this is one we would like to joint-venture with you, in which we own half of it and you own half of it. We would be responsible for one-half of the deficits that incur on this program, and we would be rewarded by one-half of whatever after-market revenues that this program would produce.

That is precisely what they are telling you they want. When they come with the 11th hour thing, Senator, every professional knows that that is a charade. And why? It is because they would divide up the schedule 22 hours. In 11 hours they would include all those news programs, all their specials, all their sporting events; the other 11 hours would be a free-fire zone. The first thing they would do is take a financial interest in every half-hour show that was presented to them. Because they know, Steve Cannell knows and we all know that hour shows are a drag on the market. You cannot give them away in syndication right now. The half hours are the ones that sell.

Right now NBC has on the air 14 half-hour shows; that is seven hours. They would load up with another couple of more hours and have maybe nine hours of half hours and then let the rest of us take over the hour shows.

To the professionals, the 11/11 is an illusion. It has no meaning. I am now done. Once they understand the FCC is not going to take their chestnuts out of the fire, then I think they will be willing to make the deal. Until their political counselors tell them that all avenues are closed at the FCC and the Congress, they are not going to make a deal; that is my judgment.

Senator INOUYE. Are you suggesting that if the FCC membership is not to their liking, then they will make a deal?

Mr. VALENTI. Yes, sir. Well, not to their liking—I mean, if they find out that the FCC is not eager for a lot of reasons, the first being that there is no case to be made on their part, why should they bring it up when the rule seems to be working? Once they realize that, then I think they will be in a frame of mind to cut this deal.

And by the way, one final thing, Senator. We have also said we are willing to make a deal not in perpetuity. Let us make it for three or four years, so that nobody is rooted in any kind of lapidary agreement.

Senator INOUYE. I have been advised that the major studios are the bankers for independent producers. And as a result, these major studios are intent upon maintaining the present arrangement because they do not want to compete with networks becoming bankers.

Is there any credence to that?

Mr. VALENTI. Well, Steve Cannell is an independent producer and he can speak to this.

Mr. CANNELL. There is some credence to it. In my case there is not. I am very entrepreneurial and I want to own my own programs. And so I did not take my network series that were sold across the street to Universal and say okay, here, take me off the hook. I decided that I would take the risk; and I would also then get the reward.

And so I go to the bank for my financing and I pay a point over prime for it, just like any other businessman. And I try and husband my costs very carefully so that I do not run out of cash and go out of business.

But, whether you look at it from the point of view of somebody like me or from the point of view of a major studio, they have the same problem. They have to either borrow money or go into their assets to deficit finance these shows. And if they pick up a show from an independent producer, what we still have is the adversary relationship that we really need to have creative programming, which is the network does not own the creative talent.

If I am having an argument with you, Senator, and you are paying my check, I am really not having an argument. What I am doing is having a forceful disagreement, maybe, at best, but at the very bottom line you can say to me: You are fired or do it my way, because you are under contract and if you do not you are in breach. Then I have lost the control. I do not work for a network.

And even if I were at a studio, I do not work for a network. Those writer/producers over there have a chance to argue and to go someplace else if they disagree, to go Jamie at Fox and say I am going go take my program over there, or I am going to take my program to CBS, if it is NBC.

Where I think the real danger lies, and I think this is where we are so frightened, at least in the creative community. If they have the right to produce all of their own programs, they will hire the producers and then we will work for them and we will be captive employees of the network. We will not be able to go across the street.

The incident that I gave you on Norman Lear will become the rule, where things will die before they have a chance to get to another network. And I think that is tremendously dangerous to the viewing public, to the whole fabric of television, to what we are trying to do. We just cannot put that kind of power in the hands of three people, whether they are benevolent or not. You just cannot allow that to happen. We will be constricted by it.

Mr. VALENTI. And I might add, Senator, that in the negotiating committee, it is composed of Bob Daly of Warner, Art Barron of Paramount, myself, and Chuck Fries of Fries Entertainment, an independent programmer, Mel Blumenthal of MTM, an independent programmer, Stuart Glickman with Carsey-Werner, an independent programmer, they do the Cosby Show and they do Roseanne, and we have Jerry Leider, who is the chairman of the Caucus of Independent Writer/Producers. This negotiating team is heavily weighted toward independent programmers like Steve, who are entrepreneurs with their own independent production companies.

Mr. KELLNER. Could I add one point, Senator? I think if you put yourself into the position of being a creative producer and you ask yourself where you wanted to work, and the network had the ability to put you on the air, and the studio could just go and try to sell your pilot to a network; and you are a very creative person with a lot of ceativity inside of you and you want to make television shows, you do not want to just get paid money, you want to make television shows, where are you going to go to work? I am going to go to work for the network who can put my show on the air and has the power to do it, versus go to work for a studio which must try to sell the powerful network to put my show on the air. It is a tremendous advantage; it is tremendous control.

Senator INOUYE. All of you were here when the first panel responded to our questions. And whenever we asked about the concerns expressed by independent producers, the response was you set up the conditions, we will take anything you want to protect the producers.

Mr. Valenti.

Mr. VALENTI. I did not hear that.

Senator INOUYE. Mr. Murphy and Mr. Tisch and Mr. Wright, in response to our questions relating to the concerns expressed by people like Mr. Cannell, always responded saying that you set the conditions and we will accept them in order to protect the rights of independent producers.

Mr. VALENTI. Well, Mr. Chairman, it is very simple. If I have the total, final decision-making authority and I have the right to own the show, and I have the right to take a piece of your show if I choose to as the price for getting on the air, I do not know what conditions you could put on there that would protect anybody's rights. They could all say well, I turned him down because I did not like his show. I took this fellow because I did like his show.

Senator Gore asked them if you have two shows equal in value which one are you going to take, the one you own or the one you do not. They never answered that question. I thought one of the gentlemen said why, of course that makes no difference. I mean, that is so ludicrous. If you believe that, then I have got some stock in some Texas S&Ls I would like to sell. It is ludicrous.

Mr. CANNELL. If I may just add to that for a second. A good example was CBS owned the Twilight Zone, which was a half-hour show. It was doing abysmally. It was not doing any business at all. They continued to renew it—actually it was an hour show that had several segments in it—they continued to renew it, where if I had the show I would have been cancelled like that. They continued to renew it to get enough episodes so that they would have a syndication package on the show.

I do not think that is in the public interest. The show was being renewed for fiscal reasons, not creative reasons. And I think that is an example of one of the things that the network—I think it was—Mr. Tisch said—well, you know, we put our shows in the worst time periods, the ones that we bought. But, you know, you do not have to be afraid of a bad time period if you are in charge of the pink slip.

You know, if I had a show and I also owned the network, I could put in a lousy time period and I could continue to renew it and make the case that well, nothing else is going to do any better than this, so let us just keep it on. These people can put a show in a bad time period with no jeopardy at all, because they have the final say over whether they remove it.

If they give me a bad time period, I am a co-financier in a disaster and I have nothing to say about it.

Senator INOUYE. What do you say to the contention that they are the ones who have to romance the producer and not vice versa?

Mr. CANNELL. Well, I have never ever had a lunch from any of these gentlemen.

[Laughter.]

Mr. CANNELL. I am certainly one of the most prominent—I have created over 20 shows—they are all friends of mine. Obviously, there is a dating game that goes on. People try to get better producers to work for them. I think that dating game is best played at a distance. I think that once any of us ever signed a contract and went over to work over there, then the dating stops. You do not get kissed any more.

Mr. VALENTI. And also, Senator, don't you find it strange that all of these independent producers are supposed to be wooed and lunched by them, nobody is on their side. No independent producer of any responsible name or reputation is allied with the networks. They are all, implacably and in a unified way, totally opposed to any change in these rules.

Because, as Mr. Cannell says, they are out of business. They become employees in the years that lie ahead. Otherwise, I would assume if there are any independent producers for the networks, they would have paraded them before you.

Senator INOUYE. Mr. Kellner, you suggested the establishment of cooperatives of various types of programs. If one of the networks decided to do what you are suggesting, should they operate under the same rules that you operate?

Mr. KELLNER. I think you are referring to the Kids' Network that we are getting involved with, with our affiliates. At this point, Fox is limited to 15 hours, after which we would have to abide by FISR. Even though, I think I pointed out in my testimony, I hope I made the point that we are no where near the power of the three networks at this point. Our revenues are under 2 percent of theirs.

Our stations U's, all of the weakness that we have, we do not believe that those rules should apply to us. And we do not believe that that was the intent when they were written. We will stop prior to 15 hours if that is what our Government tell us we have to do.

The attempt to create the Fox Kids' Network is something that did not begin with Fox Broadcasting Company. It was brought to us by our affiliates, one of them in particular who got this idea. We took the position that we would set this up as a cooperative venture with all of the profits flowing to the affiliates, not to Fox Broadcasting Company. So this is not an attempt to avoid rules, this is a true cooperative in every way. It is a business that our affiliates are already in; it is not something that Fox is starting up, like putting prime time programming onto independent stations.

We also felt it was inappropriate for us to try to take what was our affiliates idea away from them. We hope there is a way to present this so that everybody realizes that this is a true program cooperative and is not part of Fox Broadcasting Company. If it is not, then Fox will be forced to stop at 14 and 1/2 hours. We will lose the opportunity to provide excellent kid's programming on a network-type service, versus what is happening right now in the barter syndication world.

I think if you look at what is on in the afternoon right now and you look at what the networks do on Saturday morning, the networks are doing a better job. There is more pro-social material, there are higher standards practiced, programs are not produced because they sell a toy, they are produced because they are good shows that are entertaining and responsible for the kids.

That is what we want to do with our affiliates across the country between 3:00 and 5:00. But that is also what a misinterpretation of this rule would prevent us from doing. Should the networks be allowed to change their business structure and avoid this rule? I think the networks will continue to be the networks. They will continue to dominate the landscape and should not be freed of restrictions so long as they dominate this industry.

Senator INOUYE. How do you respond to the suggestion made by the first panel, that the major studios are the power in the United States. Their income, as compared to that of the networks would be something like 10 to 1.

Mr. VALENTI. That is quite absurd, Mr. Chairman. I do not know, with the exception of Disney, I do not know a single production company whose stock has doubled in the last three years as has ABC and CBS. I do not know of any.

For example, what they do not tell you is the losses taken by production companies in deficits of failed shows. Remember, when the networks pay a license fee—and by the way, Senator, they pay the same license fee, pretty much the same—they do not bid against each other for entertainment series license fees—$850,000 to $900,000 is what they pay for an hour show. They get two runs for that $950,000.

The first time they run it, they get a lot of advertising revenue. The second time they run it, they run it free. And the only thing they pay on the second run is some residuals. It is almost impossible to lose money.

And by the way, Senator, we have put on the table for the networks, as a counter to their 11/11, not only our joint venture—we said look, I will tell you what we will do, we will scrap the rule entirely and you can have a financial interest in every show you want, but we want the same financial interest in the advertising on that show. What is wrong with that? That is fair. You get a 50 percent interest in our show and we get a 50 percent interest in your advertising.

They avoided that like it was bubonic plague. They did not want any part of it. It is off the table. They do not even want to discuss it. Because it is almost impossible for the networks to lose money when the second run of that show is free to them. However, if after one year or two years they cancel that show, they have made money on it, but the producer is choking on deficits. He cannot eat them. And it is gone forever. He does not have enough episodes to syndicate.

And one final thing. Mr. Murphy says we can only have a show option for four years. They used to have shows optioned for seven years. They would have had 100 years except the usury laws in California made them stop at seven. It was one of the things that was revised in a consent decree. The Justice Department filed an antitrust suit against them and part of the decree that they signed says that they cannot go more than four years on an option.

That expires in 1995. And in 1995, the networks will manacle Mr. Cannell to them for at least seven years, which means for fixed price, no change except maybe a few percentage points a year, and they will own him for seven years. I do not think that is right.

Senator INOUYE. Mr. Cannell, you have indicated that you are independent businessman and you go to the bank like anyone else to borrow money. I do not suppose that applies to the smaller producers?

Mr. CANNELL. It does to some. I mean, there are—because the business is so difficult right now, if I were to start again I do not think I could make it. I needed some hit shows, which I was able to do when the business had a little bit more in the syndication back-end profits; and when I got those hit shows, then I can go to the bank and leverage them and sell my contracts for money to the bank, basically. It is like factoring almost.

If I were going to start today, I would be in desperate trouble because I might not be able to carry the deficits that I would be asked to carry long enough to get into syndication.

And you must remember that if I go to the bank and borrow $100,000 or $200,000 on the first episode, I cannot get any back from that until that show gets off the network. If it is five years, six years, seven years—and, of course, I want the show to stay on because that is how I am going to make profits, but I have to carry that $200,000 loan on that first episode for seven years, and pay interest on it for seven years. And the same on all the others that go on behind it.

So I need the syndication market place in order to get out of trouble. It is a terrible situation that we are in right now. I mean, it used to be much better because the syndication market place was a much lusher place and, in success, you could sell a show for $500,000 or $600,000—it even got up to the point with Magnum where it was over $1.7 million per episode.

So it was a great business at that point, but what happened was when that marketplace died, we were in a position where we no longer could carry these deficits and we had to cut back our production costs. A lot of companies are shooting out of the country for that reason. So, it has become very difficult to do. And now, to have these people raise the specter of going into the one place where we had a chance to come out, and now own that as well, as a quid pro quo for allowing us on their network, it seems to me—that is why I say I think the future of my company is at stake with this rule.

Senator INOUYE. Mr. Valenti, as you noted, we asked the three network to share with us there financial data. And I believe it was Mr. Wright who suggested that the studios should do the same thing. Would that be possible?

Mr. VALENTI. I will certainly ask them, Mr. Chairman.

Mr. CANNELL. Well, I certainly will give you mine, and it will scare you.

Senator INOUYE. We would like to see that, because you are one of the major independent producers, are you not?

Mr. CANNELL. Yes.

Senator INOUYE. And if we could have a couple of small ones do the same.

Mr. VALENTI. I will make inquiry of some of Mr. Cannell's confreres in the independent production business, and I will talk to the members of my association. I hope that you will get from the networks their breakout of costs and revenues and their allocation of burden between their O&Os, which are massively profitable, and their networks, to see how they transfer their costs back and forth. I think that would be a useful figure. At one point the FCC had that information; they do not have it anymore.

Senator INOUYE. We intend to do that.

And I forgot to make this announcement when we opened the hearings today, but because of the importance of these hearings and because of the importance of the record, we will have to rely upon the record if we are to make any recommendations to the Senate, I would like to invite all of you to look over the transcript, and if you wish to make corrections or addenda, clarification or supplementals, please feel free to do so. Because oftentimes, sitting on a panel you may say something and later on realize it was not what you intended to say.

I thank you very much, you have been extremely helpful.

Our next witness is the President of WLVA–TV of Baton Rouge, Mr. Cyril Vetter.

Mr. Vetter, I thank you for your patience, and we look forward to hearing from you, sir.

STATEMENT OF CYRIL E. VETTER, PRESIDENT AND GENERAL MANAGER, WVLA–TV, BATON ROUGE, LA

Mr. **Vetter**. Thank you, sir. I appreciate the opportunity to be here.

I am a little disappointed that I do not have the opportunity, Senator, to commend Senator Breaux on behalf of his constituents in Louisiana on the outstanding job that he does for us. Would you convey that to him for me please?

Senator **Inouye**. Well, right now they have luncheon meetings and other hearings in progress, so. And I did not want you to come back after the recess, which would be a month from now.

Mr. **Vetter**. Mr. Chairman, my name is Cyril Vetter, and I am President and General Manager of WVLA–TV in Baton Rouge, Louisiana, a UHF station affiliated with the NBC Television Network. I am also the owner of WVLA and I manage the station operations on a day-to-day basis. I am a real grassroots television operator.

I am also Chairman of the NBC Affiliates Government Relations Committee, and to that extent I represent the viewpoint of the 200-plus television stations affiliated with the NBC Television Network.

I also convey letters that I will offer for the record from the Chairman of the Government Relations Committees of both the ABC and the CBS affiliates organizations supporting my comments this afternoon. So in that sense I represent the views of over 600 local television stations across this country affiliated with CBS, ABC and NBC.

It is wrong to say that the networks have no allies in this matter. They do. It is the 600-plus television stations across the country who are affiliated with ABC, CBS and NBC.

And my purpose here is to convey in the clearest possible terms why repeal of the financial interest rules are necessary to secure a viable future for the local television service that my station provides, and why these rules are contrary to the public interest and fundamentally unfair to the whole network affiliate system.

I know this committee will hear many eloquent presentations about the extent of changes that have occurred in the national video delivery marketplace since these rules were adopted back in 1970. But let me help you to appreciate the significant changes that have occurred in the local marketplace, and in this case Baton Rouge, and Baton Rouge is fairly typical of the rest of America.

In 1970, the average television household could receive about seven television channels. Today the average household can watch 27 channels.

In Baton Rouge, cable penetration which was virtually non-existent in 1970 now reaches nearly 70 percent of the local television homes, excluding homes uneconomic to wire in the rural areas, or homes that cannot afford cable television, inner-city homes.

If we assume that the average Baton Rouge cable subscriber has a choice of 27 channels, then it is not hard to imagine the competition that WVLA-TV faces. On a typical cable console, my station is just another button among many at the subscriber's fingertips. That is fierce competition.

The competition for the viewer's attention becomes fiercer still when we add to this the tremendous increase of VCR ownership and movie rentals, and the growth of back yard satellite dishes.

In this multitude of program services, the network affiliate station still provides a unique service to millions of Americans. The more than 200 NBC affiliate stations reach about 99 percent of the Nation's television households—in major markets, in medium markets like Baton Rouge, and in small markets across the length and breadth of our country.

While there are other national and local media services, the network affiliate station delivers a unique blend of national and local broadcast service. The strength and appeal of our network/affiliate relationship are as much the result of our teamwork as our individuality.

Indeed, both NBC and its affiliates would agree that we offer our viewers a better broadcast service together than we could ever deliver separately. As a result, the public interest value of our service would be significantly diminished if our network partner suffered financial reverses and the quality of network programs declined.

What is the public interest value of this local service? It is the early and late news programs, the weather reports, the reports of the storms in Washington recently, the tornadoes in Louisiana recently, sports reports, public service programs, emergency announcements, and other programs which the network affiliate station and the network affiliate system, really, delivers on a daily basis.

It is a local information service designed to serve the interests of the local community. It is a service that lies at the heart of the licensing scheme in the Communications Act.

And let me stress, Senator, that this service is expensive to produce and maintain. I know this firsthand and painfully. We must hire studio anchors, news reporters, back-up crews, production crews, we must build and maintain studios and studio sets, purchase and maintain state-of-the-art production equipment and automobile fleets and satellite trucks and other equipment.

And no other television program providers have shown a comparable interest in starting up a similar local-based service, meaning that the network affiliate stations must continue to be a major source of local news and information.

But it takes a strong financial base to sustain this service. As I have said, a strong network partner is crucial to maintaining the revenues needed to produce quality local programs. For example, the advertising revenues generated by the sale of commercial announcements inserted adjacent to network programs represent a major share of station revenues.

Furthermore, a strong network partner means that local stations can dedicate more dollars to maintaining and enhancing a local news service, which is very expensive.

Let me say, Senator, that WVLA and the other NBC affiliates are not intimidated by being just another button on the cable console. We welcome that competition; it serves the American television viewer. We believe ours is a unique service that will attract the attention of that viewer.

At the same time, however, we believe it is fundamentally unfair and potentially threatening to our business, we even heard senators say that free television is on the way out, it is unfair and threatening to our business when other program providers on that cable console are free to negotiate for financial interest in the programs that they acquire, while ABC, CBS and NBC are still prohibited from negotiating for those rights.

Now, I am not suggesting that the network business will come crashing down tomorrow if these rules are not repealed, but I am saying that there appears to be a basic inequity in the present rules that work to the benefit of our competition. These rules have put pressure on network revenues, I read about this every day in my local paper, they put accompanying pressure on the network/affiliate partnership, pressure on local station revenues, audience shares and the program services that our network affiliate system is able to provide.

I will say further that the network/affiliate service cannot survive indefinitely if competitive program suppliers have access to these additional sources of revenues, while our network partners do not.

We heard some very depressing and very discouraging comments from some of your colleagues on the panel about the future of free television.

Without question, the video delivery marketplace is undergoing major change. Cable networks, first-run syndicators, Fox Television, and other program providers are growing stronger financially and fast. In this new environment, it just does not seem fair that NBC, ABC and CBS should be handicapped by rules that restrict their ability to invest in new program opportunities when other well-capitalized competitors are not so handicapped.

And finally, I do not believe that the public interest is best served by retaining rules that apply only to the three networks, where a reasonable connection exists between those rules and the ability of the entire network/affiliate system, the local station system, to furnish the quality and unique blend of local and national news, information, public affairs, and entertainment programming.

And thank you very much for this opportunity to speak.

Senator INOUYE. Mr. Vetter, have you always supported elimination of the financial syndication rule?

Mr. VETTER. As long as I have been in the business. Yes.

Senator INOUYE. In your view, is that—if it is not eliminated, the future of over-the-air free television, is in jeopardy?

Mr. VETTER. Yes. It is in jeopardy already, Senator Inouye. We see the major events migrating away from free over-the-air television. And, really, there is no such thing as free, over-the-air television in any practical sense.

In my market, for example, almost 60 percent of the people who watch my station have to pay to watch that station.

Senator **Inouye**. Do you not believe that the present profit margin is sufficient to keep them going?

Mr. **Vetter**. I believe the present profit margin is under great stress, because of the fact that the competition for the television viewing public has so many other potential profit sources, while we have only one.

Senator **Inouye**. Well, Mr. Vetter, I thank you very much for traveling this long distance to be with us, and waiting all morning to testify. I thank you, sir.

Mr. **Vetter**. Thank you, sir, for the opportunity to be here.

Senator **Inouye**. Our final panel consists of Mr. Edward O. Fritts, President of the National Association of Broadcasters, and Mr. Andy Schwartzman, Executive Director of Media Access Project of Washington.

I thank you for your patience. Mr. Fritts.

STATEMENT OF EDWARD O. FRITTS, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF BROADCASTERS

Mr. **Fritts**. Thank you, Senator.

We would like to take advantage of your offer to file additional information and materials for the record, following the conclusion of the hearing.

Senator **Inouye**. The record will be kept open, sir.

Mr. **Fritts**. Thank you, sir.

I guess being on the last panel provides us opportunity—and the luxury, if you will, to close the loop and talk about many of the issues which have been raised during these three days of hearings. I compliment you on conducting these hearings.

As you know, more than 50 years ago, Congress established a communications structure, which was based upon a nationwide system of free, over-the-air broadcasting. Communities would receive local service by radio and television.

As television evolved, we have seen this system grow up, and quite frankly, to flourish into a system that serves our nation well.

Communities receive universal free news, entertainment, and so forth. Now, the effect of this system, is that broadcasters can do well by doing good.

Congress has regulated this system extensively over the years, including through the ownership regulations that have been the focus of these hearings, to promote competition, diversity and public service.

The ownership restrictions include foreign ownership, cross ownership, multiple ownership, and local ownership rules.

We are seeing the communications marketplace change enormously. Some changes are the result of technology, some are the result of new entrants into the video and audio marketplace.

There has, literally, been an explosion of new radio and television stations through the years. Add to that the growth of cable, satellite, wireless cable, VCRs, and even the potential of the telephone companies being in the television entertainment business.

We think the problem is not new media competing for time and the attention span of the public. Ideally, the public interest is served by these new choices, and the diversity that these new players bring to the marketplace.

Broadcasters are used to, and welcome fierce competition. However, we would point out that competition, necessarily, has to be fair.

What we have today is not fair competition. Newer media have largely gone unregulated in their growth. Or, in fact, they have been totally deregulated.

Broadcasters are going up against competitors with our hands tied behind our backs. Witness the Cable Act of 1984, which has been the focus of a portion of these hearings.

As we look at what has taken place in the last five years, since this Cable Act was passed, we see a greatly changing landscape in communications.

The Chairman of the Energy and Commerce Committee on the House side, John Dingell recently said, and I quote, "From where I sit, it appears that cable does not have to answer to anybody. That is not a good thing. In our system of checks and balances, everyone answers to someone, except, apparently, the cable industry."

Today, Mr. Chairman, the top five cable MSOs control 42 percent of the Nation's subscribers. That compares to 28.9 percent in 1985. So we have seen in just four years growing concentration, if you will, in the top multiple-system operators of the cable systems in this country.

And then there is the question of regulatory consistency. If Congress is regulating broadcasting because of its concerns about diversity, and to protect the public interest, should not this logic also apply to the new media?

We believe that Congress and the public still value our system of free, universal, over-the-air broadcasting, and want it to remain a vital part of America's future. In fact, our future should not be a world of communications divided between the haves and the have-nots.

To keep free over-the-air broadcasting strong, we feel Congress should restore fair competition. Essentially, you have two choices: Lift the regulations on broadcasting, or balance the scale by regulating the new competitors.

Quite frankly, we do not expect that Congress will deregulate broadcasting. In fact, some of these hearings are asking for more regulation. In that light, we would suggest that the centerpiece of reregulation for the cable industry should focus upon "must-carry" and channel repositioning, to guarantee that those stations which have been licensed to serve local communities are not foreclosed from doing that as they are transmitted through the cable monopoly bottleneck.

You may also want to consider other regulations on cable concentration, and ownership, and we would comment on those at the appropriate time.

At some point, Congress will have to ask similar questions about how the telephone companies should be regulated, when its integrated, broadband network is available in consumer homes.

In closing, Mr. Chairman, we thank you for the opportunity to testify. We will be happy to work with the Congress as you begin to legislatively address these important communications issues. Thank you.

[The statement and questions and answers follow:]

STATEMENT OF EDWARD O. FRITTS, PRESIDENT & CEO, NATIONAL ASSOCIATION OF BROADCASTERS

I am Eddie Fritts, President and Chief Executive Officer of the National Association of Broadcasters. The NAB represents more than 5100 radio stations, 970 television stations and the major broadcast networks.

NAB applauds the Communications Subcommittee for convening these hearings on ownership and concentration issues within the communications industries. It has been a number of years since the Congress has taken a comprehensive look at the structure of the electronic mass media, one of our nation's most dynamic sectors. The issues you are examining not only include intra and inter-media competition, but also fundamentally involve the distribution of much of the news and entertainment that is available to the public.

As this Subcommittee is well aware, ownership of broadcast facilities has been regulated virtually since the inception of broadcasting. The goal of Congress and the Federal Communications Commission has been to ensure that ownership of the broadcast media, which is built upon a foundation of localism, remain in the hands of United States citizens and that it not fall under the control of a few large companies. The premise of these ownership principles is that the public is more likely to be exposed to a wider range of viewpoints if there is a more diverse ownership of radio and television facilities. In effect, regulation of the broadcast media's structure substitutes for direct regulation of its content, in keeping with the free speech and press protections guaranteed by the First Amendment.

Regulation of broadcast ownership, both at the national and local market levels, has been pervasive. Most rules have proscribed certain types of ownership combinations, while others have sought to increase diversity by encouraging more ownership by certain groups.

The most basic of the nationwide broadcast ownership rules is the "12 station rule," which largely limits the number of stations a single entity may own or control to 12 AM radio stations, 12 FM radio stations, and 12 TV stations (or a 25% national audience "reach," whichever limit applies first). Other nationwide ownership restrictions include the ban on foreign control of broadcast licenses (Section 310 of the Communications Act), and the FCC's network/cable cross-ownership rule, which prohibits the three major television networks from owning cable systems. You also have heard testimony on the FCC's rules that apply to ownership of certain program interests by the television networks.

At the local level, Congress has barred television stations from owning cable systems in the same market (Section 613 of the Act). The FCC prohibits broadcasters from owning daily newspapers in the same market. In addition, the FCC has imposed the duopoly rule, which prohibits broadcasters from owning two or more stations in the same service where their signals would overlap, and the "one-to-a-market" rule, which bars common ownership of radio and television stations in the same market.

As I noted earlier, both Congress and the FCC have implemented policies which attempt to increase holdings by groups that traditionally have been under-represented in acquire up to 14 stations in each service if the additional stations are "minority-controlled." The FCC's tax certificate and distress sale policies also were designed to encourage transfers of stations to minority owners. As you are aware, these minority provisions are undergoing increasing scrutiny in the courts.

While the goal of the ownership regulations -- preservation of competition and diversity -- has remained the same, the broadcast marketplace which they regulate has changed dramatically over time. The biggest change has been the vast increase in the total number of radio and television stations now serving local communities.

In 1934, when the Communications Act was passed, all of broadcasting was comprised of just 677 AM stations.[1] Today, there are 4950 AM stations on the air. In addition, 4192 commercial FM stations, 547 commercial VHF television stations and 523 commercial UHF stations also serve local communities throughout the nation.[2]

This explosion in the total number of radio and television facilities has occurred in markets of all sizes. Even the smallest markets average nine radio and television outlets.

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[1] Print and Electronic Media: The Case for First Amendment Parity. Printed for the use of the Committee on Commerce, Science, and Transportation, S. 98-50, 98th Congress, 1st Session.

[2] Broadcasting, June 19, 1989, pg. 16.

Our largest metropolitan areas average 71 radio and television outlets.[3] Our latest radio listener study shows that the average listener has more than 26 radio stations available from which to choose.[4] In television, 93% of the nation's households now can receive seven or more channels.[5]

This increase in the total number of stations and the growth of broadcast competition within individual communities makes it even less likely that a few broadcast companies will dominate, either nationally or locally. As a result, revisions to a number of the ownership regulations have been possible. One of the most noteworthy of these was the modification of the "7-7-7" rule to the present "12-12-12" rule, which became effective in 1985. This modest expansion of ownership concentration took advantage of the economies of scale that function within the broadcasting industry to increase the breadth of views presented to the public. Larger stations groups are better able to bear the risks of program development and production, and can devote greater resources to the service of their local communities.

The modifications to the broadcast ownership rules have not harmed competition within the broadcasting industry, nor have they lessened the diversity of views available to the public. Broadcast ownership remains diffused. In radio, 32.9% of stations are group-owned (AM-FM "combos" are not included within this definition of group-owned),[6] but the top 100 radio station groups earn only 50% of total radio revenues.[7] Only one radio station group currently owns the maximum number of 12 AM stations and 12 FM stations.[8] Less than 5% of radio stations are held by groups which own 15 or more stations.[9]

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[3] An Analysis of Media Outlets by Market. Peter Vestal, Research and Planning Department, National Association of Broadcasters, June 15, 1987.

[4] NAB National Radio Listening Study. Ed Cohen, Research and Planning Department, National Association of Broadcasters, November 2, 1988.

[5] Nielsen Report on Television -- 1989.

In television, group ownership of stations is more prevalent than within radio. As of January 1, 1988, 497 of the 647 stations in the top 100 markets were owned by groups. However, the number of groups in those markets totals more than 100, and there are more than 191 television group owners overall.[10] Television concentration has remained low, even though the total number of television stations one company may control has been lifted. In 1987 the top 10 television station groups attracted a smaller share of national broadcast audiences ("circulation") than the top 10 television station groups did in 1977.[11]

While statistics provide only a dry, abstract view of how diverse and competitive the broadcasting industry is, our day to day operations paint a more vivid picture. From a personal perspective, I can assure you that the broadcasting industry is hotly competitive at all levels. NAB's member radio and television stations and our networks battle fiercely every day to win tenths of percentage points of shares away from each other.

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[6] NAB membership database.

[7] Broadcasting, June 5, 1989, pg. 51; citing Drew Marcus, Kidder, Peabody & Co..

[8] NAB membership database.

[9] Broadcasting, June 5, op. cit.

[10] Group and Cross-Media Ownership of Television Stations: 1988. Herbert H. Howard, April 1988, published by the National Association of Broadcasters.

[11] Broadcasting, June 5, 1989, pg. 48; citing David Waterman, Annenberg School of Communications, University of Southern California.

NAB will continue to support moderate revisions to the broadcast ownership rules when they are warranted by changing marketplace conditions, and when they can be accomplished without substantially impacting upon the diversity of viewpoints available to the public. For example, NAB has supported the FCC's revision of the duopoly rules for the AM service, to permit commonly-owned stations to be located closer together. NAB believes, as does the NTIA, that AM radio can regain some lost momentum if it is able to take advantage of the economies of scale and cost savings permitted by joint ownership in nearby markets.

The local media marketplace is far more than just broadcasting, however. While once the electronic media were comprised solely of broadcast outlets, today's world is vastly more complex. As I noted earlier, there are more and more broadcast outlets on air. These outlets not only compete among themselves – they also increasingly are vying for the time and attention of the public with newer media competitors, such as cable systems, satellite receivers, wireless cable, and video cassette and video disc players.

Congress and the FCC undoubtedly will continue to be sensitive to concerns about competition and concentration within the broadcasting industry. Your oversight of the broadcasting industry, however, should encompass today's broader media landscape. A more comprehensive examination leaves the inevitable conclusion that broadcasting's newer competitors have been allowed to go largely unregulated, whether by accident or design. Despite the change in marketplace circumstances, only broadcasting remains covered by the umbrella of restrictions designed to prevent dominance at both the local and national levels.

It is not apparent why this should be the case. The same concerns about diversity and competition should apply with equal validity to these newer media. In addition, the disparity in regulatory burdens has tipped the scales of competition.

This lack of fair competition among communications providers has serious implications. First, this country has chosen to rely to the largest extent possible on competitive forces to ensure that the public can receive diverse viewpoints. Our reliance on competition began long before the "let the marketplace decide" era of the early-to-mid 1980s. Second, the backbone of our country's communications system has been free, over-the-air local broadcasting. Broadcasting's ability to compete fairly with all comers will determine whether we remain a vital industry well into the future.

These competitive imbalances are most evident in our dealings with the cable industry. You already have heard testimony in earlier sessions on how difficult it is for broadcasters to compete with a largely unregulated local monopoly. I wish to associate myself with a number of points raised in that testimony.

The 1984 Cable Act has resulted in virtually the total deregulation of cable. In the five years since its passage cable has been allowed to consolidate considerable power. If this trend continues over the next five years, the communications marketplace may be irreparably harmed.

At the national level, with no ownership limits to control its growth, cable is becoming increasingly concentrated. In 1985, 70% of nationwide subscribers were controlled by the top 50 cable MSOs. Today, only 20 MSOs control 70% of the nation's subscribers.

While cable's nationwide consolidation is troubling, its real power is felt in local markets. Although television broadcasters are restricted to a single outlet, cable has control over its multiple channels. Broadcasters fight for audiences with many other stations in their markets, but cable has a local monopoly. Less than 1% of cable companies face any direct competition from other systems. Only 32 of the more than 8000 cable systems nationwide are "overbuilt."[12] Monopoly franchising and the absence of carriage regulations leave broadcasters and subscribers subject to the whims of the cable system operator.

In short, cable has been permitted to become the gatekeeper to the home. It faces no direct competition from other cable systems. It has total discretion over the carriage of local broadcast stations. These monopoly systems increasingly are being owned by large integrated corporations that have interests in programming in addition to cable's distribution plant. These monopoly cable systems now have incentives to place at a disadvantage the programming offered by local television stations. More and more programming is being syphoned away from free television to cable services.

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[12] Cable TV Franchising Newsletter, Paul Kagan & Associates, Carmel, California, October 1988.

NAB believes that if Congress does not act to restore fair competition between broadcasting and cable, then the long-term vitality of broadcast television will be jeopardized. Our society may become divided into the information "haves," who can afford to subscribe to subscription video, and the "have nots," who can not afford those services.

In our view, this regulatory imbalance leaves two options for Congress. It can relax or eliminate regulation of broadcasting to free it to compete with the unregulated cable industry. Or, it can impose reasonable regulations on cable to rebalance the competitive scales.

NAB believes that it is highly unlikely that Congress will eliminate such regulation of the broadcasting industry. Nor, in some cases, is it clear that deregulation of broadcasting truly could rebalance the scales. As a result, we have called for Congress to re-regulate certain aspects of the cable industry, and I renew that call this morning.

From our perspective, the most important step Congress can take is to implement reasonable must carry and channel positioning legislation. Local television stations must be assured of a fair opportunity to reach the citizens in the communities they are licensed to serve. In addition to carriage regulations, Congress may wish to consider additional restrictions on cable's ownership. NAB would be pleased to work with this Subcommittee and other Members of Congress, as well as with the cable industry, to develop appropriate legislation.

On behalf of NAB, I appreciate your attention to our views on these important media ownership issues. I would be happy to respond to any questions that you might have.

RESPONSES TO QUESTIONS

1. Although the FCC relaxed its multiple ownership rules to permit the ownership of 12 TV, 12 AM, and 12 FM stations by one entity, very few companies have taken full advantage of the change, why is that?

There are various reasons why stations owners have not taken advantage of the FCC's national multiple ownership rules and acquired 12 TV, 12 AM and 12 FM stations. First, it must be remembered that these are maximum limits that were designed to allow growth from the former 7-7-7 standard. The FCC found the old rule to be too restrictive and yet found the new limit an effective means of regulating national media concentration. It was not anticipated at the time that all group owners would immediately acquire the maximum number of stations. Second, for television stations there still exists an audience reach cap of 25 percent, which could inhibit stations from owning 12 television stations. Third, the regional nature of broadcasting and the local multiple ownership rules perhaps have contributed to station ownership limitations. Fourth, the decline in AM radio dominance has made some AMs less viable station acquisitions. Finally, the competition for stations in all size markets affects the ability of any group to own the maximum number of stations.

2. The FCC is considering relaxation of the cross-interest policy to permit, for example, one individual to have a 49% interest in every station in a market. Has the NAB taken a position in this proceeding?

In comments before the FCC, NAB argued for elimination of the policy and, if needed, the adoption of specific rules. NAB pointed out that the ad hoc nature of the policy coupled with the lack of clearly articulated guidelines could cause broadcasters to forego many business opportunities that further the public interest. While NAB did not address specifically the situation of an individual having a 49% interest in every station in the market, NAB believes the FCC could still seek comment on this situation. If it is determined that such a prohibition is necessary, NAB would not object to implementation of a clearly articulated set of guidelines prohibiting certain relationships. The key is that broadcasters need to know definitely what is prohibited and what is permitted.

3. In the last 5 years, has there been a significant change in the type of entity that owns broadcast stations?

This is a very difficult question to answer given the lack of clarity of the term entity. Specifically, it is unclear whether you refer to the structural form of the entity or its character. The FCC has and continues to license broadcast stations to all types of entities, including sole proprietorships, partnerships and various forms of corporations. In initial licensing and in transfer and assignment situations, the FCC still must determine the character of the proposed licensee and make a determination whether grant of the license furthers the public interest. While there has been speculation that the nature of licensees might have changed over the years, there is no evidence that there has been any change. NAB believes that the bottom line for broadcasters continues to be service to local audiences.

4. There has been an increase in hostile take-overs of broadcast stations. Has this been good for broadcasters? The public?

Actually, according to FCC records there have been few hostile takeover threats in the last few years, and none has been successful. The threat of hostile takeovers is just another piece in the puzzle of today's communications marketplace. Although ownership of broadcast stations is no longer a safe haven for companies desiring to avoid hostile takeovers, the threat of takeovers has not changed dramatically the way broadcasters do business.

5. Does the NAB support the FCC policies designed to promote minority ownership?

NAB continues to support policies to promote minority ownership and equal opportunity for minorities. As you are aware, NAB helped initiate the tax certificate policy and has been on record in favor of the distress sale policy. NAB also founded the Broadcast Capital Fund to help minorities finance broadcast properties.

6. What is the NAB's position on the FCC's process for licensing translators and the current rules concerning operation of translators?

NAB urged the FCC to commence a Notice of Proposed Rule Making on the issue of FM translators. NAB believes the current process has allowed numerous translator entrepreneurs to take advantage of loopholes in the rules to turn translators into offensive and defensive weapons. NAB has requested the FCC adopt new technical, ownership and other rules designed to return translators to their original purpose of being a fill-in service in unserved or underserved areas.

In addition, NAB would like to emphasize that it continues to oppose the reimposition of three year holding rule. NAB does not believe that the public has been harmed by its elimination. To the contrary, station owners have been allowed to compete unencumbered by obsolete rules on ownership.

Senator **Inouye**. Is channel positioning that serious a problem?

Mr. **Fritts**. Channel positioning is certainly a serious problem, Mr. Chairman. In some instances, when stations are moved to higher channels, the second sets in homes which are hooked up to cable may not be able to pickup the higher channels.

So, automatically, for instance, if you have a bedroom set that is not cable ready, and it is hooked up without a converter box, then you can only watch a limited number of programs. You are precluded from watching those stations which have been shifted to higher channels.

Senator **Inouye**. I asked that question because the witnesses suggested it was not a problem. That, usually, they just wanted to be next to you.

Mr. **Fritts**. Well, I cannot speak to what the other witnesses said, but, clearly, it is a very serious problem, and one that needs to be addressed.

Senator **Inouye**. Do you also believe that over-the-air free television is in jeopardy?

Mr. **Fritts**. Mr. Chairman, as long as we have to operate with government restrictions, and our competitors do not have governmental restrictions, there is an unfair advantage tilting toward the competitors of broadcasting. We think that, certainly, we can see the diminution, if you will, of audience shares and opportunities for broadcasters to reach their markets.

Senator **Inouye**. And you contend that if we cure the channel positioning problem, and insist upon "must-carry," that would provide you with a level playing field?

Mr. **Fritts**. We think that is the first step toward a level playing field. Clearly, there are ownership issues and other concentration issues that we would be happy to comment on as legislation continues to wind its way through Congress.

Senator **Inouye**. Thank you, sir.

Mr. Schwartzman.

STATEMENT OF JAY SCHWARTZMAN, EXECUTIVE DIRECTOR, MEDIA ACCESS PROJECT

Mr. **Schwartzman**. Thank you, Mr. Chairman.

I know you and I agree that the top priorities for this subcommittee remain the Fairness Doctrine and children's television. I hope you also agree that the most imminent threat to diversity is the growing power of cable. Certainly, that is the consensus of every witness who has testified today.

But there is plenty to be concerned about in the broadcast arena as well. There is a direct relationship between the FCC's modified regulation of broadcast ownership, and the erosion of license responsibility.

A new breed of broadcaster has emerged, concerned only about short-term profitability and today's ratings. These people regard themselves primarily as investors, not as trustees of a scarce public resource. They see broadcasting as just another business. For them, the only difference between a broadcast license and a hamburger franchise is that the one from Burger King is not free. Their perspective is measured in 13-week cycles. The economies they generate are diverted to debt service, not to program service. In fact, the first thing they do is lay off the local news staff. Locally-generated revenues are exported for new acquisitions in other markets.

Mr. Chairman, all this has happened with legislative acquiescence, on your watch. Everything I have just described has been effectuated under authority the FCC claims to have received from Congress. You have the power, and I believe the duty, to fix things up.

The First Amendment imperative is to insure vibrant, robust debate on public issues. Over-the-air broadcasting remains the most powerful and effective device to shape public opinion ever created. As an elected public official, you know full well just how important and how powerful.

Congress must make sure that broadcasting serves the listener, and not the other way around.

The basic bargain is this: broadcasters volunteer, and willingly compete, to be selected as licensees. In return for the monopoly right to use public airwaves, they agree to do so responsibly, and to serve the public's needs as well as their own.

The system has worked reasonably well. Broadcasting, as Mr. Fritts has already said, came to be known as a business, where one could do well by doing good.

But since 1981, the FCC has been engaged in the systematic effort to change the terms of this trade.

The good news is that it has been only partially successful. The bad news is that it has been partially successful. The consequences are there to be heard and seen.

Perhaps the greatest shortcoming of the current FCC's analysis has been its position that at some point there is enough diversity, and that other considerations—specifically, the supposed virtues of economic efficiency—can be given primacy.

I have set forth in my written statement a comprehensive package of recommendations for you to consider.

One all-too-representative example is the FCC's repeal of its so-called trafficking rules, which Senator Hollings addressed earlier today. Until 1982, the FCC ordinarily declined to allow the sale of a broadcasting property for three years after its acquisition. Waivers were frequently granted for good cause.

The FCC's expressly stated objective in repealing the three-year holding period was to let the market define a broadcast station's "higher valued" use.

This is nothing more than an auction of public property for private gain. It flatly contravenes the public interest concept, which recognizes that the market does not define the highest use, since many citizens—the very old, the very young, the poor—lack market power.

In repealing the three-year rule, the FCC claimed, with a straight face, that buyers would be "station doctors," that they would "infuse new capital and/or new ideas into a failing station, making it more responsive to the public." But we got is faith healers, praying at the altar of debt service. They run up prices, not service, and the public is worse off for it. That is just one example, but I have a long list in my written statement.

One other matter of particular immediacy is the Commission's policy to facilitate hostile takeovers by abusing so-called "STAs." That is a device originally intended to assist broadcasters in meeting emergency needs, such as when a transmitter collapses during a storm.

Although the legality of this policy is highly suspect, Judge Bork issued an opinion which rendered it essentially unreviewable in a court of law.

The FCC clearly intends to use this mechanism so that arbitragers, stockbrokers, and junk bond dealers can finish off what the FCC has started: A concerted effort to destroy the public interest standard.

You have the power to stop this, and I hope you do. Thank you, Mr. Chairman.

[The statement and questions and answers follow:]

TESTIMONY OF ANDREW JAY SCHWARTZMAN
EXECUTIVE DIRECTOR
MEDIA ACCESS PROJECT

There is a direct relationship between the FCC's modified regulation of broadcast ownership and the erosion of licensee responsibility. A new breed of broadcaster has emerged, concerned only about short term profitability and today's ratings, not long term loyalty. These people regard themselves primarily as investors, not as trustees of a scarce public resource. Traditional up-through-the-ranks broadcast managers have been supplanted by MBA's with no prior interest in, or commitment to, public service. Broadcasting is, to them, just another business. The only difference they see between their license and a hamburger franchise is that the one from Burger King isn't free. Their perspective is measured in 13 week cycles. They cut costs no matter the long term consequences. They are willing to replace stable programming with more sensational fare even if it won't hold audience attention far beyond the next ratings period. The economies generated thereby are not recycled to program service, but are diverted to debt service. Locally generated revenues are not reinvested locally, but are used for new acquisitions in other markets. Local news and public affairs staffs have been laid off and local programming capability scrapped entirely.

Mr. Chairman, all this has happened with legislative acquiescence. Everything I have just described has been effectuated under authority the FCC claims to have received from Congress. You have the power, and I believe, the duty, to fix things up.

The technology of data transmission is now a multi-billion dollar international trade issue. But, while the scope of governmental involvement has necessarily increased over time, the need for federal intercession is not new. In fact, technology has rendered such intervention necessary for much of this century.

In the most elemental sense, the public policy goal with respect to the mass media is to insure the most vibrant, robust debate on public issues and to provide the opportunity for the transmission of the widest range of cultural and artistic expression and, secondarily, for commercial speech insofar as it promotes an efficient marketplace for goods.

Mr. Chairman, I must start by pointing out that the two most important items on my legislative agenda are not on today's agenda. First, I trust you will remain firm in your insistence on prompt enactment of S.577, your bill to reinstitute the fairness doctrine. Second, I must add my voice to those you have already heard in urging that the growing power of cable TV poses an imminent threat to broad public access to diverse speech. I have included as an attachment to these remarks my recent testimony supporting restrictions on foreign ownership of cable. That bill, I emphasize is only a necessary interim step to deal with the massive power which comes with a cable franchise. The long-term solution is re-regulation of cable.

Over the air broadcasting remains the most important, and most powerful, tool for shaping public opinion ever created. As an elected public official, you know full well just how important, and how powerful broadcasting is.

The basic bargain is this: broadcasters volunteer, and willingly compete, to be selected as licensees. In return for the monopoly right to use public property - the airwaves - they agree to use the airwaves responsibly, and to serve the public's needs as well as their own.

The system has worked reasonably well, especially since 1966, when citizens gained standing to participate in the license renewal process by means of then-Judge Warren Burgers' landmark decision in Office of Communication of United Church of Christ v. FCC, 359 F.2d 994 (D.C. Cir. 1966).

Historically, the public interest standard was interpreted so as to favor local service delivered by locally oriented owner-operators. Broadcasting came to be known as a business where one could do well by doing well, trading public service for the protection of a monopoly license. The emphasis has been on holding broadcasting properties for the long term, in a business which generated one of the very highest rates of returns on capital investment in all of American industry.

It's been a good deal for two generations of broadcasters. But since 1981, the FCC has been engaged in a systematic effort to change the terms of this trade. The good news is that it has been only partially successful. The bad news is that it has been partially successful. The consequences are there to be seen and heard.

The core objective of mass media policy has been to create a well-informed electorate by exposing citizens to the broadest possible range of issues, ideas and entertainment. Perhaps the greatest shortcoming of the current FCC's analysis in recent years has been its advocacy of the view that once a sufficient level of diversity is obtained, diversity can be treated as a secondary criterion, and considerations of supposed economic efficiency can be given primacy.

The factual analysis underlying the FCC's premise is flawed,[1] but the concept itself is truly pernicious. At root, the FCC is satisfied to find "enough" speech, and an industry which already holds the limited number of available licenses is willing to agree that there should be no one else allowed to join the debate. That is not what the Supreme Court held, unanimously, in 1978, when it upheld the Commission's newspaper/broadcast cross-ownership rules. Justice Marshall said at that time that "the Commission has chosen on a 'sensible basis,'... to further, rather than contravene, "the system of freedom of expression.'" FCC v. NCCB, 436 U.S. 775, 802 (1978)[quoting T. Emerson, The System of Freedom of Expression 663 (1970)].

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[1] I cannot make a better case for the shortcomings of the FCC's perceptions than the one made by the Senate Commerce Committee itself. Report of the Senate Commerce Committee on the Fairness in Broadcasting Act of 1987, S. Rept. No. 100-34, 100th Cong., 1st Sess. (1987).

Diversity is achieved in part through requirements that broadcasters carry certain kinds of programming, such as the equal opportunities provisions of Section 315 of the Act, and the fairness doctrine. But regulation which bears on program content is undoubtedly constitutionally sensitive. So-called structural regulation, which determines who is licensed in the first place, is a far more effective and desirable mechanism to achieve these public policy goals. Indeed, even many of those who have criticized content regulation such as the fairness doctrine have conditioned their opposition upon effective ownership regulation to achieve diversity through more indirect methods.[2] Thus, as a Republican dominated Commission said just a few years ago,

> If a city has 60 different frequencies available but they are licensed to only 50 different licensees, the number of sources for ideas is not maximized. It might be the 51st licensee that would become the communications channel for a solution to a severe local crisis. No one can say that present licensees are broadcasting everything worthwhile that can be communicated.

Multiple Ownership of Standard, FM and TV Broadcast Stations, 22 FCC2d 306, 311 (1970).

A comprehensive package of recommendations is set out below. A more thorough discussion of a few of these will serve to underscore the broader elements of these measures.

Example: The Financial Interest, Syndication and Prime Time Access Rules

First, I strongly support retention of the financial interest and syndication rules, as well as the integrally related prime time access rule.

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[2] For example, Judge David Bazelon, who is often cited as an opponent of content regulation, repeatedly emphasized the importance of maintaining diversity in the regulated mass media. He stressed that "structural regulation, through anti-trust policies, cross-ownership limitations and content-neutral access requirements permit rectifying undesirable aspects of the market without government involvement...."

The adoption of these three interrelated rules in 1970 and the subsequent growth of a new and vibrant independent television station sector literally created the market for first run syndicated TV programming, and enabled countless new production companies to get started. As a result, Americans get more programming on more stations from more different producers. The rules enhance democratic values, and we're better off for them.

It was fashionable a few years ago, at least in some circles, to argue that the best economic regulation is no economic regulation.

That was wrong then, and it's wrong now.

The financial interest, syndication and prime time access rules are pro-competitive, content-neutral, and self-enforcing.

Even so, the networks are taking another shot at repealing them. Sure, the three networks' audience share has declined from humongous to merely oppressive, but much of this loss is to independent TV stations and pay cable, which can't compete for national advertising. And they've broadened their base of profitable owned and operated stations, adding markets like Philadelphia and Miami.

What the networks don't like about these rules is that they've worked. But that's hardly a reason to repeal them.

Example: Three or Five Year Minimum Holding Period For Broadcast Licenses

Until 1981, the FCC ordinarily declined to allow the sale of a broadcasting property for three years after its acquisition. Waivers were frequently granted for good cause. A three or five year rule should be reinstituted.[3]

The FCC's repeal of the three year holding period was undertaken with the expressly stated objective of letting the market define a broadcast station's "higher valued use."

This is an auction concept, plain and simple. It is flatly contrary to the Congressionally dictated "public interest" concept, which recognizes that the market does not define the highest use, since many citizens and interest groups - the very young, the very old, the poor - lack market power.[4] Moreover, even as an auction mechanism, the current system benefits the wrong party. I vehemently oppose auctions, but if there were to be an auction, the profit should go to the public, not to the outgoing licensee.[5]

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[3] New stations must now be held for one year after they go on the air. A three or five year rule should be extended to these properties as well.

The station trafficker is not seeking to act as a trustee. He - and under this system there are more he's and fewer she's than otherwise - is in broadcasting for short term profit. Audience loyalty is of minimal concern here. Innovation - anything that may take time to become profitable - is disfavored, and short-term solutions - such as cost cutting through eliminating local production and hypoing ratings with promotional gimmicks, become essential to survival.

The local owner, heretofore a fixture in the community, is being replaced by blind investment pools which are accumulated through explicit commitments to sell within a given period, and not to hold properties. As the SEC filings make clear, these new owners are investors, not broadcasters, who care about capital gains, not building businesses which will be profitable over the long term.

Another group being driven out by the higher prices are minorities, people for whom the down payment was never easy to pull together.

The Commission was utterly, totally, wrong in characterizing the new entrants attracted by repeal of the 3 year rule as "station doctors" who are supposed to "infuse new capital and/or ideas into a failing station making it more responsive to the public."

"Faith healers" praying at the altar of debt service would be a more apt description, people who slip into town in the dark of night, make a few promises, cast a few spells, and leave before the next sunup. In city after city, we've had local news and public affairs staffs totally eliminated.

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[4] Virtually all of the broadcasting industry, I should note, including the NAB, joins me in opposition to spectrum auctions.

[5] An even more alarming instance of this auction concept is the FCC's recent decision in Rebecca Radio of Marco, 4 FCC Rcd 830 (1989). There, the Commission disrupted the comparative hearing process for new licenses by introducing auctions. The Marco decision permits third parties to enter a pending hearing at the eleventh hour for the sole purpose of buying out the valid applicants. This permits minimally qualified parties with deep pockets (typically white males) to prevail over the parties who had filed under the existing diversity-oriented criteria. The decision has been widely condemned by citizens, minority and women's groups, industry trade associations and the organized bar (including the Federal Communications Bar Association).

The trafficking rule is a particularly well-honed tool. It's good public policy, because it is targeted at the abuses, but leaves room for legitimate exceptions. Anyone who can show that strict application would cause undue hardship or gross inequity can obtain a waiver. And this Commission, in particular, never met a waiver it didn't like.

What is needed now is not a 3 year rule, but a 5 year rule. The logic behind the 3 year rule as adopted in 1962 was that 3 years was equal to a license term. This was not mere coincidence - it was an important enforcement mechanism. It guaranteed that every broadcaster would have to face the hurdle of at least one license renewal before a sale could be effectuated. Renewal terms are now 5 years for TV and 7 for radio. A 3 year rule means that the quick buck artists can get in and out without ever having to face the scrutiny of the FCC.

Example: Consider the Character of Applicants for a Broadcasting License

Until issuance of its Character Policy Statement on January 14, 1986,[6] the FCC administered Section 308(b) of the Communications Act "under the regulatory premise that there is a nexus between character and future licensee performance; that an applicant with good character more likely will meet the elevated standards of a public trustee." Notice of Inquiry In the Matter of Policy Regarding Character Qualifications in Broadcast Licensing, 87 FCC2d 836, 837 (1981).

The Character Policy Statement represents a major change in the Commission's approach. Rejecting a long line of judicial precedent, the Commission expressly held that Section 308(b) and the similarly worded Section 319[a] "do not of themselves require that the Commission make any inquiry into the character qualifications of broadcast applicants." Character Policy Statement, supra, 102 FCC2d at 1187. [Footnote omitted.] It redefined the focus of its future inquiries to a "less value-laden" process which "will be concerned with misconduct which violates the Communications Act or a Commission rule or policy, and with certain specified non-FCC misconduct which demonstrate the proclivity of an applicant to comply with our rules and policies." Id., 102 FCC2d at 1190-91.

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[6] Report, Order and Policy Statement In the Matter of Policy Regarding Character Qualifications in Broadcast Licensing, 102 FCC2d 1179, recon. denied, 1 FCC Rcd 421 (1986).

In consequence, the Commission now refuses to designate a hearing to explore evidence of an applicant's legal misconduct in non-FCC related matters other than three specified categories.[7] No matter how egregious or indisputable, evidence of misconduct which is still in litigation, even for years, will not be explored. Nor will the Commission examine even overwhelming evidence of misconduct which is resolved by consent decree.

In blinding itself to the possibility, and even the probability, that a particular applicant may not be suitable for licensure, the FCC significantly contributes to attracting the wrong kind of licensee into broadcasting. The Commission overlooks the fact that there may well be many other violations of law which, under the circumstances, demonstrate a strong "proclivity" to ignore the interests of the public.[8]

The public depends on broadcasters for truthful and accurate news and information, and has made broadcasting the primary source of information used in deciding for whom it will vote. Is it inevitably the case that one who is found to have put personal interests ahead of the public by shortweighting or mislabelling inferior products has no greater propensity than others to favor an advertiser's interest or fail to address issues of importance to an economically deprived segment of the community?

The Commission's handling of criminal misconduct is especially troublesome. Although the very same conduct can be a misdemeanor or a felony (or even no crime at all) depending on the jurisdiction, the FCC has adopted an irrebuttable presumption that persons convicted of misdemeanors, no matter how many, or how flagrant, still have a "proclivity ... to deal truthfully with the Commission and to comply with [its] rules and policies." Character Policy Statement Reconsideration, supra, 1 FCC Rcd at 422.[9]

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[7] They are: fraud committed against a government agency (but not private persons), felony convictions and antitrust adjudications relating to broadcasting.

[8] For example, a willingness to mislead or defraud investors (as opposed to the government) can often have a strong bearing on an applicant's suitability to be a licensee.

[9] The Commission's treatment of felony convictions is closer to the mark, since the Character Policy Statement at least mandates examination of the circumstances underlying the conviction. But even here, the Commission stresses that "criminal convictions not involving fraudulent conduct are generally not relevant to an applicant's propensity for truthfulness and reliability, ..." Character Policy Statement, supra, 102 FCC2d 1197. [Footnote omitted.] The Commission refuses to acknowledge that many crimes

The Nation's federal prisons are rapidly filling up with involuntary refugees from Wall Street. It is not at all far-fetched to hypothesize a newly retired young stock trader using the remains of his or her bankroll, and a jailhouse telephone, to purchase a broadcast property. Depending on the plea bargain, such a person may well not have been adjudicated guilty of a crime the Commission considers to be one of dishonesty. Misdemeanors - even scores of them - would not disqualify such Yuppie entrepreneurs from receiving an FCC license.

An Agenda For Diversity

With this background in mind, I urge the following steps be taken:

1. Establish and retain criteria which insure diversity in, and integrity of, the award of new broadcast licenses.

Certain members of the federal judiciary seem to doubt that Congress has found a nexus between minority and female ownership in the mass media and the creation of diverse marketplace of ideas. *See*, *Shurberg Broadcasting of Hartford, Inc. v. FCC*, No. 84-1600 (Order Denying Suggestions for Rehearing *En Banc*)(June 16, 1989). Congress must disabuse these judicial activists of this notion by making necessary findings and again directing the retention of FCC policies on comparative enhancements for minority and female applicants, minority distress sales and tax certificates.

The FCC has decimated the comparative hearing process. For a measured and thorough discussion of how this has undermined the diversity goals of the Communications Act, I respectfully refer you to the recent comments of the Federal Communications Bar Association ("FCBA") filed in opposition to the FCC's proposal to replace the comparative hearing process with a lottery as well as the various reform proposals contained therein.[10]

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of violence show a disregard for human life which make one wholly unsuited to be a broadcaster, and that property crimes similarly evidence a predisposition to violate the public trust. So, too, the Washington *Post* has recently reported on the FCC's processing of a convicted drug dealer's application submitted from the jailhouse!

[10] I served as a member of the *ad hoc* committee which drafted the FCBA comments.

2. Require purchasers of broadcast properties to demonstrate their qualifications prior to allowing the transfer or assignment of a license.

In the guise of neutrality, the FCC has adopted a policy which allows the misuse of so-called "STA's" for the purpose of facilitating hostile take-overs.[11] This is hardly a neutral posture - it is one which invites the wrong kind of investment into broadcasting. Although the legality of this policy is highly suspect, Judge Bork issued an opinion which rendered the policy essentially unreviewable in a court of law. See Office of Communication of the United Church of Christ v. FCC, 826 F.2d 101 (D.C. Cir. 1987).[12]

Congress should overrule this misguided policy.

3. Retain limits on network power.

As noted above, I join those who believe that limitations on network dominance have been central to the evolution of meaningful local competition and created an environment for evolution of a healthy production community. In addition to the measures earlier discussed, I also favor retention of network/cable cross/ownership limitations.

4. Retain and enforce limits on local media ownership.

While the FCC has adhered to the view that concentration of control at the local level poses the greatest threat to diversity, it has nonetheless gutted its regulation of such ownership. Even more insidiously, it has adopted a policy of freely granting waivers of existing ownership rules. Congress must restore policies which allow the creation of such locally powerful combinations.

It bears particular emphasis that structural rules pertaining to ownership are prophylactic in nature. They serve to avoid creating conditions which result in abuse. It is far easier, and societally much more preferable to deter adverse situations than to try to undo damage after the fact.

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[11] STA's were originally conceived as a mechanism to deal with emergencies, for example, to permit use of a temporary transmitter in the wake of a hurricane.

[12] Judge Wald dissented. She stated that if the merits could be reached, she "would hold that the FCC's new policy...goes beyond its statutory power." Id. at 113-14 n.6 (Wald, J., dissenting).

The Commission repealed its regional concentration rules in 1984. Report and Order, 101 FCC2d 402 (1984). As a consequence, broadcasters have obtained ever greater degrees of concentration within small geographical areas, for example within a single state. More recently, the FCC weakened, as to certain radio station, the so-called "duopoly" rule allowing ownership of stations with overlapping signals. First Report and Order, 4 FCC Rcd. 1723 (1989). While it purported to have made only minor revisions to its all-important "One-to-a-Market Rule" (which forbids the acquisition of a second broadcast property in the same market), the actual text of the Commission's decision in that case is far broader than it was described in public statements. Second Report and Order, 4 FCC Rcd. 1741 (1989). Thus, the Commission greatly liberalized waivers in the top-25 markets so as to make them essentially automatic, based on a highly questionable conclusion that economies of such combinations will invariably be reinvested in local service.

There is yet another, even more ominous threat just ahead. The FCC has signalled its intent to repeal its cross-ownership policy. Further Notice of Inquiry/Notice of Proposed Rulemaking, 4 FCC Rcd. 2035 (1989). This essential rule precludes combinations not involving direct ownership, or which involve broad ownership not amounting to control. Without it, a single person could own 49% of every single station in a market, and the station manager of one station could be the owner of its principal competitor.

5. Local cross-ownership rules, especially as to newspaper/broadcast cross-ownership must be retained and vigorously enforced.

Congress has already spoken to the dangers of local newspaper/broadcast cross-ownership. There is no greater threat to vigorous debate on local issues than placing the ownership of the two most influential of the mass media in the same hands. Existing rules, and existing policy underlying them must be left in place.

6. Identify the true owners of broadcast properties and hold them accountable.

The FCC has adopted a series of decisions which have the effect of masking the true party in interest in a broadcast application, so that a nominally qualified "front" is credited as the licensee even though the true owner is an unqualified hidden party who may have massive media interests which greatly limit diversity.

Two decisions in particular merit revision. One is the FCC's modification of its "attribution rules" so as to disregard owners of up to 5% of a broadcaster's stock and "passive" ownership of up to 10% in calculating ownership. Certain trust holdings were similarly freed from ownership restrictions. At the same time, the FCC reduced the disclosure requirements necessary to enforce even the remaining ownership limits. Attribution of Ownership Interests, 97 FCC2d 997 (1984), recon. granted in part, 58 RR2d 604 (1985), further recon. granted in part, 1 FCC Rcd 802 (1986).

The second ownership policy change restricting diversity is a determination to disregard the media properties owned or operated by limited partners in calculating the media interests to be charged to an applicant for a new property. Anax Broadcasting, Inc., 87 FCC2d 482 (1981). The stated objective of this well-meaning policy was to enable minorities and women to obtain financing, but in practice it has led to the filing of innumerable applications of dubious integrity.

ANSWERS OF ANDREW JAY SCHWARTZMAN TO POST-HEARING QUESTIONS OF CHAIRMAN INOUYE

Although the FCC relaxed its multiple ownership rules to permit the ownership of 12 TV, 12 AM and 12 FM stations by one entity, very few companies have taken full advantage of the change, why is that?

I do not entirely agree with the premise of your question, Mr. Chairman. It is my impression that as to radio, a significant number of broadcasters have reached or approached the 12 station limit for each of the AM and FM services. As to television, it is true that only one group is presently at or near the 12 station limit. However, other stations have stated their intention to acquire the full complement of 12 stations.

There are several reasons why more licensees have not yet reached the maxima established under current regulations. In the case of television, the most important factor is that there have not been a large number of good television properties available for sale.

I would emphasize that what has transpired hardly vindicates the FCC's action lifting the old 7-7-7 limitation. To the contrary, it demonstrates that the FCC's repeal of the old limit was deregulation for the sake of deregulation, and that the FCC was wrong when it claimed that the old 7-7-7 rule was constraining marketplace forces.

So-called "structural" limitations on media ownership such as the 7-7-7 rule (or the current 12-12-12) rule set an outer limit on how much power will be placed in a single licensee's hands. Such prospective rules serve an important prophylactic function since the potential for abuse of such power is continuing societal danger. That few broadcasters have chosen to expand is hardly a reason to allow such expansion; rather, it is a cause for rejoice, and an opportunity to restore protection for the public before more harm is done.

What is your opinion of the FCC proceeding looking towards relaxation of the cross-interest policy to permit, for example, one individual to have a 49% interest in every station in a market?

I strongly oppose the FCC's proposal to extend prior actions which had already cut back on its cross-interest policy. My views are set out in length in reply comments submitted to the FCC on May 8, 1989.

As your question suggests, there are many circumstances where those with less than a controlling interest in a broadcast property can have excessive power in a local media market. For example, the FCC has proposed to permit "key employees" of one station to hold ownership in a second competing station in the smae market. It defies credulity for the FCC to say that, since a station manager of station A has a fiduciary duty to station A's ownership, she will not take actions which assist station B in which she has an ownership interest. But, to pick just one scenario, what if a consultant tells her choose one of two new formats for station A, and one choice will benefit station B's competitive standing vis a vis a third station C?

The FCC emphasizes the supposed restraints on market forces created by the cross-interest policy. It ignores the benefits of the policy, which was designed to promote both economic competition and diversity of ownership. The Commission suggests that othe multiple ownership rules will restrain excessive power, but those rules address national, not local power and, as discussed above, don't even do that well. Moreover, as with the multiple ownership rules, the greatest value of the cross-ownership policy is its prospectivity, which stops problems before they cause harm.

> **The FCC recently "relaxed" the one-to-a-market rule, to permit broadcasters to own two broadcast stations, an AM and a TV station in one market. The FCC found that if one licensee owns two stations in a market, he will increase the news and public affairs carried on both stations. Do you agree with this decision?**

I am in partial agreement with the FCC's action easing the one-to-a-market rule, but I disagree with several key elements of its action.

Originally, the Commission proposed to repeal the current one-to-a-market rule in its entirety. To the extent that the FCC ultimately agreed to retain the rule for small and medium-sized markets, I support the decision. However, insofar as it "relaxed" the rule for larger markets, I think this is unfortunate.

The old rules functioned quite well. The Commission freely granted waivers where good cause was shown, but the rules served to protect against anti-competitive abuse, such as questionable cross-promotion.

Having decided to retain the rule, the Commission has instead announced an even more liberal waiver policy. The implementation of this new standard is a matter which merits close Congressional oversight. In particular, the Commission's decision is based on the flat assumption that the creation of an AM-TV combination in the top 25 markets will inevitably result in programming and other benefits to the public.

There is little evidentiary basis for the FCC's assumption that broadcasters will share the economies generated by cross-ownership with their audiences. In fact, there is strong economic incentive for broadcasters not to do anything the FCC does not require of them. Unless the Commission receives written demonstrations of how this will be accomplished, the Commission should not grant the waiver. The demonstration must be even stronger in smaller markets.

What is the opinion on the FCC's process for licensing translators and the current rules concerning operation of translators?

I believe that the FCC has been extremely lax in scrutinizing translator applications, allowing some broadcasters in distant markets to pre-empt the possibility of other broadcasters starting new full power stations which will serve the local community.

I am especially unhappy about recent changes which permit national satellite-fed programming to service translators. This can destroy the opportunity for the development of local programming.

Senator INOUYE. On this three-year rule, are you describing for the committee the new breed of owners of broadcast stations?

Mr. SCHWARTZMAN. Yes, I am. The opportunity to flip stations turns them into mere commodities. It draws a different kind of investor in.

The FCC's Anax policy, which I discuss in my written statement and its attribution rule changes, have encouraged creation of limited partnerships, which are being sold to dentists on golf courses, not to broadcasters.

Instead of having people who worked their way up through the industry, the way Mr. Murphy did—now, you have got people for whom this is just another business. And I think there is a direct relationship between those people entering the business, and the deterioration in standards which has been discussed today.

Senator INOUYE. So you are saying that the one-year rule, and the hostile takeovers are not good for the public?

Mr. SCHWARTZMAN. Absolutely. As I said, I think there is a deterioration in service which is directly attributable to those changes.

Senator INOUYE. Mr. Fritts, what do you think?

Mr. FRITTS. Certainly, I disagree with my friend, Mr. Schwartzman. Any person, whether it be a dentist or a broadcaster who grew up in the business, does not want to erode the assets of a radio or a television station. The fastest way to do that is to reduce service to the public, because broadcasters still do well by doing good.

It is true that in 1985 and 1986, there was a large number of station transactions, prompted not only by interest in broadcasting, but also by tax-law changes and low-interest rates. It offered opportunities for many broadcasters, who are good, solid-citizen broadcasters, to expand their holdings in this business.

Senator INOUYE. So you are not in favor of the three-year rule?

Mr. FRITTS. No, sir, we are not.

Senator INOUYE. What about the FCC policy to promote minority ownership? Are you in favor of that?

Mr. FRITTS. We are, indeed. As a matter of fact, the FCC acted upon some of the initiatives to promote minority ownership that the NAB espoused to them, and first originated on behalf of including more minorities in our business.

Senator INOUYE. What about the FCC's process for licensing translators?

Mr. FRITTS. Well, in terms of translators, there have been great abuses of the FCC rules. We would like to see some modifications to the rules, and we would also like to see the rules that are on the books be enforced.

Senator INOUYE. What sort of modifications are we speaking of here?

Mr. FRITTS. We are looking at where people have moved translators in, not to provide service to a particular community, but to financially benefit themselves. They retransmit stations, which may be as much as 500 miles away, to the local audience using an over-the-air translator, which has basically been turned into a low-power FM service.

And there are entrepreneurs who are taking advantage of loopholes in the FCC rules to dilute the effectiveness of local stations, which provide local news and public service, and public interest activities.

Senator INOUYE. Mr. Schwartzman, do you have any views on the financial interest syndication rules?

Mr. SCHWARTZMAN. I sure do, Mr. Chairman. First, in strongly supporting retention of the financial interest syndication rules, I always include the phrase, "And the integrally related prime time access rule."

That is of particular salience this morning, Mr. Chairman. Mr. Vetter has just stated that, at least on behalf of himself, and presumably on behalf of some other network affiliates, he no longer supports retention of the financial interest syndication rules. But he did not mention the prime-time access rules, which were adopted at the same time as the financial interest and syndication rules.

To put it bluntly, it looks like there has been a trade. The networks have agreed to leave the prime-time access rule in place for their affiliates, in exchange for support on repealing the financial interest and syndication rules. I think all three are good rules, and I think they each should be retained.

I would be very much interested in knowing if Mr. Vetter would change his mind if the prime-time access rule, which has no independent justification, would be repealed at the same time.

The fact is that the adoption of these three interrelated rules in 1970, and the subsequent growth of a new and vibrant and independent television sector, literally created the market for first-run syndicated programming. And it enabled countless new production companies to get started.

Mr. Cannell, quite properly, views this in terms of getting his business off of the ground. But I view it in terms of listeners having access to more programming, on more stations, from more different producers, and more different sources.

I think, therefore, the rules enhance democratic values. We are much better off for them.

I would also add, Mr. Chairman, that the rules are symbolically important. It was fashionable a few years ago, at least in some circles, to argue that the best economic regulation is no economic regulation. That was wrong then, and it is wrong now.

The financial interest syndication and prime-time access rules are pro-competitive, they are content-neutral, and they are self-enforcing.

Really, what the networks do not like about these rules is that they have worked, but that is hardly a reason to repeal them.

Senator INOUYE. Well, much as I would like to sit here and listen further, I have been advised that there will be another committee conducting a hearing here in a few minutes.

So with that, I would like to thank both of you, and all the other witnesses for waiting all these hours to testify and assist us. And as I indicated, Mr. Schwartzman, if you wish to clarify or add to your statement, feel free to do so.

Mr. SCHWARTZMAN. Thank you, Mr. Chairman.

Senator INOUYE. Mr. Fritts will be doing that.

Mr. FRITTS. Thank you, Senator.

Senator INOUYE. We now stand in adjournment.

[Whereupon, at 1:40 p.m., the hearing was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

K-SAT BROADCASTING

COMMITTEE OF 435

"We The People"

THOMAS P. WITHERSPOON
4705 Princess Anne Lane
Jacksonville, Florida 32210
Telephone 904-389-2128

June 30, 1989

The Honorable Daniel K. Inouye
Subcommittee On Communications
United States Senate
Room 227 Senate Hart Office Bldg.
Washington, DC 20510-6125

Dear Senator Inouye:

As Networks Issues Coordinator for the C-SAT Committee of 435, I feel that I must try to correct an erroneous answer that was given by one of the witnesses at your hearings on Cable TV and Media Concentration June 22nd. I am, by the way, only aware of this error because of the replay of the hearings on the C-SAT satellite radio station.

On the second day of the hearings, Senator Pressler asked the three heads of the TV Networks about the scrambling of their signals and their progress in covering the unserved "white" areas with translators. The translator question was avoided by all three network heads, as they are fully aware that translators will never get their signal to the unserved. However, the head of CBS, Lawrence Tish, stated that "they do scramble their (CBS's) signals, but they give decoders in the white areas".

CBS is just about fully scrambled, but I can assure you that they do not "give" decoders to anyone. CBS is using the most sophisticated and expensive commercial scrambling system available, The VideoCipher I. The descramblers cost $4,000 each, and cable's VideoCipher II system is a toy in comparison.

Possibly Mr. Tish was referring to the deal made with cable TV in last year's Home Satellite Copyright Act (HR 2848), whereby dish owners who absolutely could not get over-the-air reception of network stations, could pay a cable company like Tele-Communications, Inc., a fee and subscribe to a scrambled package of three network affiliate stations.

This "solution" to the problem of access to Network programming by the rural television viewer, is, in fact, blatant discrimination by the television Networks. Over 90 percent of the nation can get network shows for free with a $10 rabbit ears antenna, but the rural TV consumer must buy a $450 decoder for his satellite system, and then pay $50-$75 yearly subscription fees, if he wants to watch the Cosby Show or 60 Minutes.

Its somewhat like the South of 40 years ago: If a non-Caucasian wanted a hamburger at Woolworth's, he had to go the scruffy little secondary lunch counter at the back of the store, and pay a higher price.

Rural TV viewers have been rejected with total indifference by the Networks. We would ask you to address this outrage in any legislation covering cable TV and networks this year. We would also like to have this correspondence included in the record from the hearings.

Sincerely,

Thomas P. Witherspoon

Thomas P. Witherspoon
Networks Issue Coordinator
Committee of 435

cc/to
Sen. Larry Pressler
Sen. Albert Gore

Cablevision of Baton Rouge
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CableVision

September 13, 1989

Honorable Daniel Inouye
Chairman
Senate Subcommittee on Communications
508 Dirksen Senate Office Building
Washington D.C. 20510

Dear Honorable Inouye:

On June 22, 1989, Cyril E. Vetter, President and General Manager of WVLA-TV in Baton Rouge, Louisiana appeared before your committee and offered comments regarding the FCC's financial interest regulations. In that testimony he made a number of remarks, particularly about cable television, that were factually incorrect. While we presume these errors were unintended, we feel compelled to correct any misimpressions the members of the Subcommittee may have formed based on Mr. Vetter's testimony, especially with regard to cable television.

Mr. Vetter stated that the Baton Rouge marketplace is probably typical of America. This comment is absurd, devoid of reality and of any empathy for the suffering that has occurred in this community in recent years. Baton Rouge, as the capital city of Louisiana, enjoys one of the highest unemployment rates in the country, along with the entire state. In fact Louisiana led in unemployment until last month when we were finally exceeded by Mississippi.

Baton Rouge along with other cities throughout the state, endures one of the worst education systems in the country. Assessment scores typically rank Louisiana in the 48-50th position of 50 states.

The local economy has been considerably depressed since 1986 when the bottom dropped out of oil prices. Advertising receipts are off considerably as many businesses have closed their doors and others cut their budgets significantly in order to survive. Though not privy to sales figures for the local broadcast stations, our own sales efforts strongly reflect a serious downturn in local ad spending, mirroring sentiments expressed by other local account managers and executives.

Mr. Vetter claims that the average household of 1970 could receive "seven channels of television service." In our "typical" town of Baton Rouge, we had two.

Mr. Vetter claims cable penetration in Baton Rouge reaches 70%. We operate that system and can claim only 52%, although we have wired most of the parish (county). We do offer 36 channels, not only the 27 stated by Mr. Vetter. And, yes, his station is "another button on the console". What Mr. Vetter failed to say is that we carry his station willingly, as do a number of other cable systems in surrounding parishes; so while he argues diminished status, he does not mention the additional reach achieved through expanded cable penetration. Since WVLA is a UHF station, his signal is the beneficiary of cable carriage, not the victim.

Further testimony states that his station, cable, VCR ownership and the growth of backyard satellite dishes all compete for the viewers' attention. This notion is refreshing since many in Congress claim cable operates unfettered by competition. The irony and reality is that, in this instance, Mr. Vetter is correct. All these media compete with each other, and in some cases very effectively, even though each medium is structurally quite different from the others. His assessment ends up supporting the FCC definition of "effective competition", a concept just as valid and important as the notion of competing TV stations or cable systems.

Yet in spite of his complaints about competition, his industry, in his own words, clearly has the edge, reaching "about 99% of the nation's television households." That remark is especially notable when one realizes that the network and their affiliates also enjoy program and affiliation exclusivity, a right Congress would deny cable television. In fact there are legislative proposals that would strip cable of any right of exclusivity to programming which the industry itself has pioneered, forcing cable to relinquish its uniqueness, and competitiveness, to groups who have contributed nothing to its programming development.

In defending the public interest value of local service, Mr. Vetter lauds "early and late news programs, weather and sports reports, public service programs", etc., that local stations produce on a daily basis. Ironically it is Mr. Vetter's own station where local news coverage was relegated to a complete hiatus for several years, and only recently reinstated. This hypocrisy is compounded by the comment, "no other television providers have shown comparable interest in starting up a similar service." While we have not attempted to duplicate the appearance of local broadcast service, as cable operators we are very much interested, and involved, in the provision of complete and accurate coverage of important community events. Our system has, for years, provided full coverage of city council and school board meetings, a task broadcasters avoided for fear of losing rating points instead of providing comprehensive and clearly more accurate coverage. We have also provided full coverage of town meetings on such diverse issues as environment, plan of government, and education. Add to the mix coverage of local college and high school sports, candidates for local and state office, call-in talk programs on medicine, law sports and even cable TV!

I recognize Mr. Vetter's presentation was intended to argue for repeal of the financial interest rules. With that purpose I have no argument. What I do object to most are his inaccurate references to an industry he apparently knows little about. As a responsible local cable operator, I am deeply concerned about recent political criticisms levelled at the cable industry, so much of which is based on serious lack of fact, misstatements, rhetoric narrow focus, absence of true critical analysis and, in some cases, just plain ignorance. Regarding my system in particular, we are very proud of our service, our accomplishments, our associates, and the community that supports us. For those reasons, I am strongly motivated to get the record straight.

I appreciate your interest and trust for your thoughtful consideration on future occasions when cable television becomes the subject of discussion. There truly is another side to the story which has not been well told.

Sincerely,

Dick Kirby

Dick Kirby
Vice President of Operations/System Manager

DK/snl

cc: Wendell Owen
Regional Vice President - Louisiana Division

Greg Bicket
Vice President - Southeastern Region

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July 10, 1989

The Honorable Daniel Inouye
Chairman
Subcommittee on Communications
Committee on Commerce, Science and Transportation
U. S. Senate
227 Hart Building
Washington, D.C. 20510

Attention: Antoinette Cook
Staff Counsel

Dear Senator Inouye:

At the request of Bob Phillips, chief executive officer of the National Rural Telecommunications Cooperative, I am forwarding a copy of the comments recently filed on behalf of my client, the American Home Satellite Association, in proceedings before the Federal Communications Commission inquiring into the existence of discrimination in the delivery of television programming in the home satellite market. (FCC Gen. Docket No. 89-88) 1/

The American Home Satellite Association is a Bellevue, Washington based organization with over twenty thousand consumer members in every state in the union, organized to advocate and represent the interests of satellite dish owning consumers throughout the United States.

In recent testimony before your subcommittee during hearings on media ownership and diversity, Mr. Phillips stated that discriminatory pricing and service policies, directed at and adversely effecting satellite dish owners and independent distributors serving dish owners, continues to be a serious problem plaguing the home satellite industry.

The comments filed by the American Home Satellite Association provide corroboration for Mr. Phillips' testimony. Specifically, a 1988 study, "A Comparison of Cable and TVRO Economics", undertaken by the Association (attached as Exhibit 1 to the comments) provides empirical documentation that:

(a) basic cable networks charge home satellite distributors an average of 712% more than they charge cable operators;

1/ The docket was not reproducible

> (b) premium cable networks charge home satellite distributors an average of 48% more than they charge cable operators; and
>
> (c) these price disparities cannot be justified by any disparate circumstances making it more costly to distribute programming to distributors for the home satellite market.

On behalf of Mr. Phillips and the American Home Satellite Association, I request that these comments, and particularly the exhibits attached to the comments, be made a part of the record in the committee's proceedings investigating media ownership and diversity.

Thank you for your consideration.

Very truly yours,

Lauritz S. Helland

MEDIA DIVERSITY,
June 14, 1989.

Hannibal Cable Consumers Association deeply feels the cable company of this county should be re-regulated.

Our cable company forced our town government to sign a twelve year contract before the time limit was up. Two weeks after the contract was signed they dropped KSDK in St. Louis and put on their own CNBC station. Therefore, we receive no Missouri news, only Illinois news out of Quincy, IL. We had lost KMOV (formerly KMOX) in St. Louis several years ago when they replaced the station with HBO, promising to reinstate at a later date.

We have started petitions for the return of KMOV and have acquired several hundred signatures. On April 17, 1989, one week later, they dropped KSDK. The demand was so great from the consumers, they returned KSDK on June 1, 1989. But they are still refusing to give us back KMOV. Though now the cable company is blacking out all programs on KSDK that are shown by WGEM in Quincy, IL, so our KSDK channel is blacked out most of the time. Therefore, our cable system in Hannibal is out several hours a week with no compensation to the consumer.

The towns surrounding Hannibal have two NBC stations and two CBS stations but they are not being syndicated. We have to pay extra for hook ups on all TV sets when the majority consumer already pays $30 to $35 per month for cable usage.

In conclusion, there is a lot of news in Government and business changes in Missouri that is never reported to us through the Illinois stations. We want Missouri sports, news, legislature news, "not Illinois!" The Hannibal mayor and council adopted the cable subscribers bill of rights in May of 1989.

ROSE WILLIAMS,
Chairman, Hannibal Cable Consumers Association.

Enclosures [1]

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[1] The enclosures were not reproducible.

MODAL LOGIC CORP.,
P.O. Box 1382
Solana Beach, CA,
92075

June 19, 1989

Honorable Sen. Daniel Inouye
Senate Committee on Commerce
Chairman / Subcommittee on Communications
SHOB 227
Washington, DC, 20510-6125
(202)-224-9340

Dear Senator:

It is my understanding that your committee is in the process of holding hearings on concentration of power in the media. As the founder (1982) of an independent small firm with an active interest in telecommunications, the media, intellectual property, and distribution thereof I would like to contribute some comments on the general issue of concentration of ownership in the media along with remarks on financing generally.

I have enclosed documents which more or less represent a corporate position paper on the matter. Areas of interest center around topics of access to distribution and production facilities, equitable licensing and maintenance of intellectual property rights.

It is hoped that this submission will contribute in some small way to your committee's work in this area.

Sincerely yours,

Michael Dvorak
President/CEO

ANTITRUST ISSUES IN THE MEDIA

This paper identifies and briefly discusses several key topics in the area of antitrust issues and concentration of power in the media. In particular some comments will be made on the current merger (Time-Warner-Paramount) and its implications for media and information distribution generally. Clearly, this text only touches on many issues that in all likelihood could be detailed at some length. In summary, any major consolidation of media distribution is likely to injure the independent producers and distributors and when permitted in apparent violation of statute, these large scale financial dealings are in effect 'monopoly subsidies' by the Federal Government, and do not contribute to greater public good, or understanding of important issues.

Special nature of media in relation to politics.

The media industry is in a unique position within the political-economic flux of the global environment. It is the 'network' that binds a country's economy together--- a source of advertising, news events, consumer goods, entertainment and information. The importance of the broadcast-media-entertainment industry to the sphere of politics cannot be denied. Besides being a major vehicle for the dissemination of news events of public importance, large broadcast-media conglomerates have been direct beneficiaries of Dept. of Justice or FCC policies regarding stock financing, ownership and concentration of power in the media over the past several years. In one case (Fox) a former President (Ford) and Secy. of State (Kissinger) have been members of the Board of Directors; in another (ABC/Capital Cities), one of the principal shareholders, the late (former DCI) W. Casey has been implicated as a central figure in a case involving diversion of government funds and significant Constitutional implications.

First Amendment issues

The First Amendment states that:

> "Congress shall make no law....abridging the freedom of speech, or of the press, or the right of the people to peaceably assemble and to petition the Government for a redress of grievances."

In effect, antitrust and to a lesser extent telecommunication statutes support these assertions. However, the apparent lack of serious review given the present (Warner-Time-et al.) merger (and other cases) by

Department of Justice Antitrust Division makes it imperative that this wrong be redressed. Lack of provision for independents is in effect subsidization of these larger firms.

Concentration of power in media

Concentration of power in an industry may take many forms. There may be contractual relationships or the influence may be more direct by directorate interlock, stock ownership or corporate acquisition.

Interlocking directorates in comparison with other large media conglomerates, do not appear to be significant within this particular merger. However, there exist directors who also sit on the board of one of the media firms and on the board of a multinational electronics firm (John Opel- IBM - Time Board) and a multinational financial institution (R.S. Troubh - Salomon Bros. - WCI Board) and who are likely to retain their directorate positions in any merged company.

Due to the large number of contractual relations it may be difficult to effectively measure the degree of control and influence these firms exercise. Clearly, however market figures show that these firms seperately or in tandem constitute a formidable market presence for independent producers or distributors.

Concentration a de facto restriction

It can be argued that large firms inherently (i.e. by virtue of their size) have an inability to deal with large quantities of information; the organizations cannot identify significant local implications of complex information, and have an inability to deal with emerging issues in more than a superficial manner. This information overload may result in rather arbitrary decision making, rewards accruing in a somewhat random manner, or accruing due to past affiliations rather than present merit. Moreover, there is no apparent standing incentive to restrict corporate goals (e.g. profits) in favor of journalistic integrity.

It is a fact that in mergers and buyouts, corporate streamlining in the resulting firm has often occurred. Implicit in this state of affairs is the notion that the policy of the parent firm is of major importance in framing policy of subsidiaries or other affiliates. Arguments that consolidations lead to measurable (accounting) efficiencies may embody circular reasoning, and obscure the key issue that production of intellectual property is fundamentally different from production of manufactured goods---q.v. standardization of product, although arguably in evidence, may not be a desirable policy----from the consumer's point of view diversity is preferred over standardization and economies of scale.

Moreover, control need not be exercised explicitly at every turn. In corporate consolidations, the opportunity for implementation of subtle mechanisms of monitoring and control is present. The point being that in a chain-of-command scenario, the 'potential' for near total control is virtually the same as near total control itself.

Essential nature of distribution channels and concentration.

The current media conglomerates deal with many wide ranging aspects. These large firms are thru their various subsidiaries involved in the production and distribution of magazines, cable television, film and television production, books, film distribution. Cost effective distribution is a necessity for effective competition. Clearly no producer can expect to recoup production costs without an audience, and there can be no audience without distribution channels. For nationwide distribution it is almost a certainty that certain firms will be dealt with, directly or otherwise.

Pricing of distribution services related to accounting.

Complex intra-organizational and inter-organizational relations render detection of violations and enforcement difficult. Long-term contractual agreements can extend over several different reorganizations making it difficult to identify much less monitor the extent and nature of transactions.

There are other functions of corporate disclosure, (e.g. ownership and major contracts, and other material market relations) besides financial statements. Consolidation generally does not contribute to disclosure of material facts that may effect future market conditions. Often Federal (SEC & FCC) requirements are the only requirements for disclosure, and as such maintenance of integrity is of primary concern.

Future breakthroughs in technology (e.g. ISDN type svcs.) are likely to render the accounting structure (SEC, and FCC Uniform Systems) even more opaque, so attention must be paid such that unauthorized cross-subsidization does not occur.

The producer should be able to gain on an absolute basis. That is the distributor's profit-per-unit, should not exceed the producer's profit-per-unit, (given reasonable profit computations). Anything else would almost certainly lead to even further concentration.

There is also the notion that concentration of ownership can lead to artificially high pricing, where financing may be used not only to accomplish market consolidation but also where finance costs may in effect be passed onto consumers in what often proves to be a monopoly market.

Lack of timely and material nature of disclosure

A problem that recurs in financial disclosure is that of full and timely disclosure of material facts. That is, materiality is often interpreted relatively, for instance on a per share basis, whereas on an absolute basis the dollar figure may be the difference between success and failure for a small firm. In particular, effective restructuring of a media conglomerate can be accomplished with minimal timely notice, the material possibly being obsolete by the time it is available in printed form.

Intellectual property rights

Due to the multinational nature and wide ranging and complex distribution system for media, it is imperative that a system for accurate and timely monitoring of accounting records exists for the purpose of royalty computation. In a very large and extremely complex distribution system the opportunity exists for hiding of royalties, and even in some cases the opportunity for 'bootlegging' of a company's own material in order to circumvent royalty payments.

Independent producer-distributor

There is the need for market liquidity for the producer, not just the ability to carry on serious negotiations with more than one potential distributor but also including the ability to make distribution deals, without 'locking in' to contractual arrangements of dubious value, or otherwise forming less than strategic alliances.

Price controls on distribution must not be such that consumers are discouraged from purchasing/subscribing products by excessive costs of distribution channels. Timeliness and completeness of accounting records are essential to royalty payments, an essential component to the all important cash-flow of independent producers.

Additionally, producers must have access to the market, and not be restricted by untoward pricing or low-return licensing or royalty agreements.

Complex organizational structures and material information.

There are complex organizational relations, dealings amongst corporate affiliates and subsidiaries, and agreements both amongst the principals and with third parties. These complex arrangements provide an opportunity for implementing various policies---editorial or otherwise in a covert manner, and result in a number of other misleading practices. For instance, appearance of diversity of programming when in fact the production of these programs may originate from the same source. Certain points of view may be presented or otherwise framed in a misleading or unfavorable context, or may be screened out entirely.

Mobility and need for independence

Clearly, the requisite focus and division of labor in a large firm is much different than in the small independent firm (where flexibility is key). In a large firm, clearly, non-conformance to corporate policy is antithetical to corporate mobility, thereby negating possibility of any real independence intraorganizationally in the large conglomerate. This difference of division of labor should not be used as an excuse for using former or other questionable or doubtful mobility considerations. Competition within an organization is not the same as competition amongst organizations, therefore in order to have a truly independent production, there must exist seperate entities.

Mobility within the industry must take on some other form other than direct organizational ties with the media-conglomerates. Without due diligence on this matter one could easily envision a scenario such that 'qualifications' are defined solely in terms of contacts with a media conglomerate monopoly distributor. This type of self-fulfilling prophecy does not lead to expression of diversity in any real sense.

Timeliness of access and compensation for denial.

There is a need for timely access to distribution and equitable compensation for the producers of intellectual property. Clearly, the concentration of ownership in the media is an important issue that needs to be addressed at the very least by legislative and administrative action. The ease with which these media conglomerates can put together rewarding financial deals of dubious public value, often with little risk to themselves, contrasts sharply with risks independent producers and distributors must endure.

The appearance of programming diversity alternates with wholesale buyouts of ever more concentrated distribution channels. Although no specific restrictive or anti-competitive actions are alleged or denied at this point, it is a virtual certainty that increasing concentration of media ownership would restrict free speech and lessen the rewards of intellectual property authorship.

References

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U.S. Code Title 47 (Telecommunications Laws)
Annual report and (SEC) 10-K, Time, Inc.
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